HSBC Global Research

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Chinese Restaurants and Food Products

Initiating coverage: Hot pot giant Haidilao set to cool

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- As restaurant chains get back on their feet, we assess growth models, potential market share gains and ESG standards
- Our analysis points to a sharp slowdown in the growth of hot pot giant Haidilao after 2023e, hitting a ceiling by 2026e
- Initiate coverage with a non-consensus Reduce on Haidilao, Buys on Jiumaojiu and Yihai; reiterate Buy on Yum China

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Back in business. Restaurants are resuming normal service after the COVID-19 outbreak. Share prices have returned to pre-pandemic levels and some have even pushed higher. We initiate coverage on three companies in the catering value chain, discuss the state of the industry and the merits of different growth models, and compare the ESG standards of covered companies. Our big call is a non-consensus Reduce rating on hot pot giant Haidilao, one of the very few on the Street.

How far can Haidilao go? Haidlilao is the world's largest Chinese restaurant company with a market cap of cUSD24bn. It has been rewarded with a premium valuation for its ability to increase market share through rapid expansion. Investors now want to know how much further it can grow the business. If our analysis is correct, then Haidilao's pace of store openings should decelerate rapidly after the numbers meet consensus expectations in 2023e, and reach a maximum store count ceiling by 2026e. This has negative implications for both its valuation and margins. The stock trades at a consensus 2022e PE of 32x. If Haidilao's revenue CAGR starts to normalise, then we think its valuation should be more in line with peer Yum China (TP USD58), which trades at a 2022e PE of 20x.

Forecasts. For Haidilao, we forecast a net profit CAGR of 30% over 2019-22e, based on a 32% revenue CAGR. For Jiumaojiu, we expect an adjusted net profit CAGR of 51% over 2019-22e on a 34% revenue CAGR. We forecast Yihai will increase both its revenue and net profit at a CAGR of 30% over the same period.

Valuation. We initiate coverage on Haidilao (TP HKD27.4), Chinese restaurant operator Jiumaojiu (TP HKD16.9) which listed in January 2020, and Yihai (TP HKD116.4), which supplies about 90% of Haidilao's hot pot condiments. **Downside risks:** a resurgence of COVID-19, intensifying competition; **potential catalysts:** improving / deteriorating growth trends.

This report replaces the version of the same date and title published earlier, to correct the decimal place in the DPS numbers for Yihai International on page 81 (should be in yuan rather than fen).

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Figure 1. Summary of ratings and target prices

Company	Ticker	Currency	Current price	Target price	Rating	Upside/ Downside	Market cap (USDm)	3m ADTV (USDm)	2021e PE (x)	2022e PE (x)	2022e EV/EBITDA
Haidilao	6862 HK	HKD	35.35	27.40	Reduce	-22.5%	24,175	40.1	40.6	32.8	16.1
Jiumaojiu	9922 HK	HKD	13.28	16.90	Buy	27.3%	2,371	13.4	37.0	25.2	12.6
Yihai	1579 HK	HKD	95.25	116.40	Buy	22.2%	12,867	23.0	71.8	56.6	35.5
Yum China	YUMC US	USD	51.11	58.00	Buy	13.5%	19,239	127.0	21.4	18.9	8.7

Source: Bloomberg, HSBC estimates. Priced as of close at 9 July 2020

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This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

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Investment summary

- We assess how much bigger Haidilao can grow its market share and restaurant network in mainland China by 2023
- Our analysis suggests growth will decelerate after it meets consensus expectations in 2023e
- We initiate on Haidilao (Reduce), Jiumaojiu (Buy) and Yihai (Buy); reiterate Buy on Yum China

The market leaders

The catering industry in China is not for the faint-hearted

In our Yum China initiation report (*Fast food, even faster growth*, 2 November 2019), we wrote that the catering industry in China is not for the faint-hearted. The market is highly fragmented, competition is intense, and the survival rate is extremely low and is likely to stay that way. We have found only two exceptions – Yum China and Haidilao.

- Yum China, which owns KFC and Pizza Hut in mainland China, has been operating in the country for more than two decades and is the dominant presence in the western quick service restaurant (QSR) segment. Its high standards of corporate governance, modern corporate structure and effective incentive schemes are the backbone of its success, especially since its spin-off from its parent, Yum Brands, in 2016.
- Back in 1994, a former tractor factory worker named Zhang Yong and three other people opened a small hot pot restaurant in Jianyang, Sichuan province. Mr Zhang and his co-founders have since turned Haidilao into the world's largest Chinese restaurant company. Haidilao operates in the even more competitive Chinese cuisine segment, which accounts for about 80% of the catering industry in China. Over 2015-19, Haidilao's revenue rose at a CAGR of 43.6% vs 9.7% for the industry. Its number of hot pot restaurants grew from 139 in 2015 to 716 in 2019, and its market share in the hot pot industry (c14% of the catering industry) rose from 1.5% to 4.5% over the same period. The company's share price has more than doubled since its IPO in September 2018.

Store count

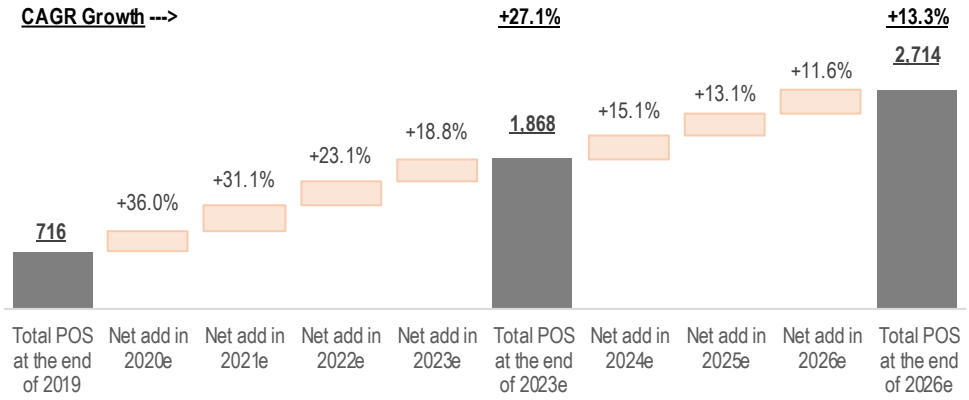
How much bigger can Haidilao grow its market share and restaurant network?

In this report we address a question that many investors have been asking – how much bigger can Haidilao grow its market share and restaurant network in mainland China? Our analysis uses two metrics to assess the depth and breadth of the company's store expansion: restaurant penetration by the number of urban population covered per restaurant at the city level, and the catering market share at the provincial level.

This exercise gives us a maximum store count of between 2,027 and 2,714 in 2026e vs the consensus estimate of 1,868 stores and restaurant revenue of RMB73.781bn in 2023e, up from 716 stores and restaurant revenue of RMB23.4bn in 2019 (a revenue CAGR of 33%). In Figure 2, we illustrate how Haidilao's growth could decelerate after it meets consensus expectations in 2023e, based on the upper end of our assessment of its potential store expansion. If we are

right, then this has negative implications for both its valuation and margins as the store count hits a ceiling by 2026e (see the chapter “Finding the ceiling for Haidilao” on page 15).

Figure 2. Blue sky scenario for growth in Haidilao restaurant numbers in mainland China beyond 2023e



Source: HSBC estimates, Visible Alpha

In the same chapter, we discuss how the eventual slowdown in Haidilao’s store expansion would affect one of the brand’s core values – the consistently high level of service across the restaurant chain which is based on an in-house mentoring and promotion system. Entry level employees have the opportunity to join a fast-track programme that offers a pathway to becoming a store manager, a position that comes with many financial benefits. In our view, as the pace of expansion slows, the chances of becoming a store manager will fall as the number of promotions available goes into decline.

Market share

Haidilao’s market share is set to rise sharply between now and 2023

Haidilao’s market share is set to rise sharply between now and 2023. Based on forecasts by industry consultants Frost & Sullivan, consensus suggests Haidilao’s market share in the hot pot segment in mainland China will grow to 9.4% in 2023e from 4.5% in 2019. This is a very high level, given the fragmented nature of the market. Some think it could be even higher. According to iiMedia, a research group, Sichuan style hot pot accounts 64.2% of the total hot pot market, which means that Haidilao’s share in the hot pot segment would go up to 15% by 2023e, based on market consensus.

In conclusion, we believe Haidilao’s share price fully reflects its potential upside and there could be risks to its margins and business model as growth decelerates. It now trades at a consensus 2022e PE of 32x. If its revenue CAGR normalised to 10-15%, we think valuation should gravitate to the level of its peer Yum China, which now trades at 1-year forward PE of 21x.

Figure 3. Summary comparison

	Yum China YUMC US	KFC NR	Pizza Hut NR	Haidilao 6862 HK	XiabuXiabu 520 HK	Yihai 1579 HK	Jiumaojiu 9922 HK	JMJ NR	Tai Er NR
Revenue 2019 (RMBm)	**60,993**	**41,978**	**14,275**	**26,556**	**6,030**	**4,282**	**2,687**	**1,372**	**1,277**
Number of POS	9,200	6,534	2,281	768	1,022	NA	336	143	126
Operating profit 2019 (RMBm)	**6,262**	**6,596**	**792**	**3,268**	**604**	**1,072**	**314**		
Market cap (USDbn)	19.2			24.2	1.2	12.9	2.4		
Consensus 2022e PE (x)	**20.4**			**31.8**	**12.6**	**50.6**	**25.4**		

Source: Company data, Bloomberg

COVID-19 impact

Figure 4. COVID-19: Restaurant closures and resumptions

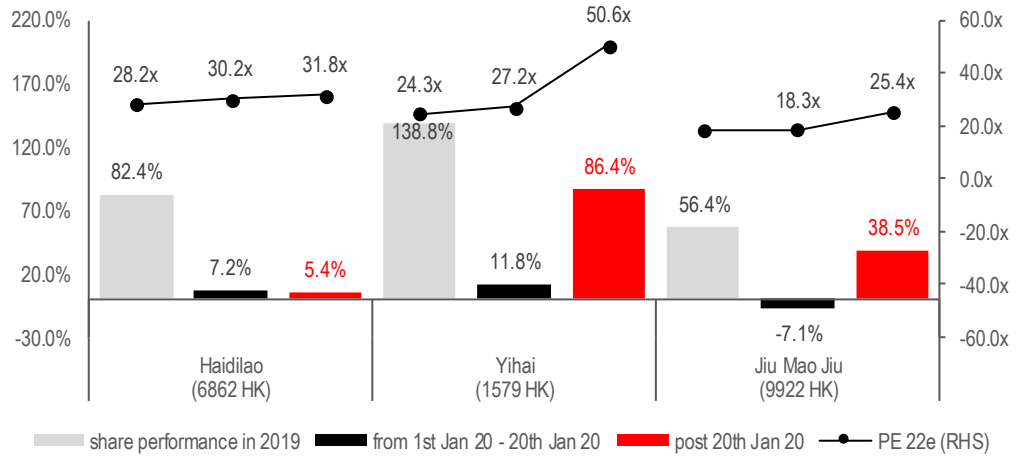
	Casual dining	Hot pot		Chinese cuisine		
	YUM China	Haidilao	Xiabu Xiabu	Jiumaojiu	Tai Er	Jiumaojiu Total
Closure date	1/24/2020	1/26/2020	1/24/2020	1/26/2020	1/26/2020	1/26/2020
Resumption date	3/23/2020	3/12/2020	10/3/2020	3/18/2020	3/18/2020	3/18/2020
Delivery resumption date	Remained open	2/16/ 2020	Remained open	2/24/2020	2/24/2020	2/24/2020
Store closed	**3,220**	**716**	**941**	**143**	**135**	**278**
as % of total restaurants	35%	93%	84%	100%	100%	100%
Resumed business	**8,740**	**650**	**866**	**20**	**132**	**152**
as % of total restaurants	95%	85%	77%	14%	98%	55%

Source: Company data

After the COVID-19 outbreak in early 2020, many restaurant companies closed stores by the end of January. They started to resume dine-in services in the second week of March. Generally speaking, they lost a month of sales.

The market appears to be looking beyond COVID-19 and share prices have returned to pre-outbreak levels and some have even pushed higher. For example, Yihai is up 86% y-t-d after its instant hot pot products enjoyed brisk sales (we estimate 1H20e revenue was up by 24% y-o-y) during the lockdown.

Figure 5. Share performance y-t-d and end of period consensus 2022e PE



Source: Refinitiv Datastream, Visible Alpha, HSBC (*JMJ is based on HSBC EPS estimates; latest pricing date 9 July 2020)

Initiating coverage

In this report we initiate coverage of Haidilao, Chinese cuisine operator Jiumaojiu (JMJ) which was listed on 15 January 2020, and Yihai, a company which supplies about 90% of Haidilao's hot pot condiments.

Haidilao (6862 HK, TP HKD27.40, CMP HKD35.35, Reduce)
Haidilao has grown into the largest Chinese cuisine restaurant company in China since its IPO in 2018. Our analysis suggests the ceiling for expanding its hot pot restaurant chain in mainland China is between 2,027 and 2,714 restaurants, vs the consensus estimate of reaching 1,868 restaurants by 2023e (source: Visible Alpha). If we are right, then its growth should noticeably

Figure 6. Summary forecasts vs consensus

Company	Bloomberg ticker	Current price (HKD)	Target price (HKD)	Rating	Upside/ Downside	2020e y-o-y Revenue	2020e y-o-y Net Profit	CAGR (2019-22e) Revenue	CAGR (2019-22e) Net Profit	vs consensus Revenue FY20e	vs consensus Revenue FY21e	vs consensus Net Profit FY20e	vs consensus Net Profit FY21e
Haidilao	6862 HK	35.35	27.40	Reduce	-22.5%	2.6%	-75.9%	31.5%	30.0%	-9.6%	-1.0%	-63.3%	-1.8%
Jiumaojiu	9922 HK	13.28	16.90	Buy	27.3%	-2.8%	-82.5%	33.8%	58.7%	-9.5%	-4.3%	-72.6%	3.9%
Yihai	1579 HK	95.25	116.40	Buy	22.2%	26.4%	29.8%	29.8%	30.3%	-3.5%	-1.8%	-1.6%	-1.4%

Source: HSBC estimates, Company data, Refinitiv Datastream
Prices as of 9 July 2020

decelerate after it meets consensus expectations in 2023e, which would have negative implications for both its valuation and margins. We expect net profit to rise at a 2019-22e CAGR of 30% on a 31.5% revenue CAGR; our net profit forecasts for FY21e/22e are 2-6% below consensus. We initiate with a Reduce rating and a TP of HKD27.40 using a DCF model with a WACC of 7.5% and terminal growth rate of 2.0%. Our TP implies 2021e PE of 31.0x and EV/EBITDA of 15.3x.

Jiumaojiu (9922 HK, TP HKD16.90, CMP HKD13.28, Buy)

Tai Er is the main revenue and profit driver

While revenue is split equally between two brands – Jiumaojiu (northwestern Chinese cuisine) and Tai Er (Chinese spicy fish, known as sauerkraut fish, a very popular dish in traditional Sichuan cuisine), Tai Er is the main revenue and profit driver. The first Tai Er restaurant was opened in 2015 and the new brand delivered a revenue CAGR of 166% over 2016-19. In 2019, with 126 restaurants Tai Er accounted for 47% of the group's revenue. As we discuss in the chapter "Two pathways to scalability", we believe the Tai Er brand has developed its own formula to scale up and it can maintain strong momentum from a low base, supported by the capital raised from the IPO. We expect Jiumaojiu's adjusted net profit to grow at a CAGR of 51% over 2019-22e on a 34% CAGR in revenue (consensus is irrelevant as a recent listing). We initiate with a Buy rating and a TP of HKD16.90 using a DCF model with a WACC of 9.5% and terminal growth rate of 2.0%. Our TP implies 2021e PE of 41.3x and EV/EBITDA of 15.3x.

Yihai (1579 HK, TP HKD116.40, CMP HKD95.25, Buy)

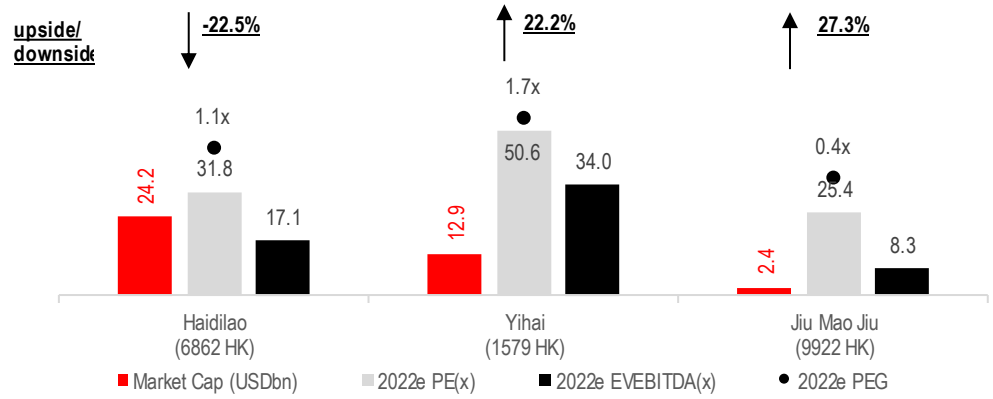
We believe Yihai can further re-rate due to its potential to grow retail market share

Yihai started out as the main supplier of hot pot condiments to its related party, Haidilao, but later grew its market share in the retail market for these products, other Chinese compound condiments and instant hot pot. We believe the company can further re-rate due to its potential to grow retail market share for Chinese compound condiments and instant food. We forecast a 2019-22e net profit CAGR of 30.3% based on a 29.8% revenue CAGR (in-line with consensus). We initiate with a Buy rating and a TP of HKD116.4 using a DCF model with a WACC of 7.5% and terminal growth rate of 3.5%. Our TP implies a 2021e PE of 77.1x.

Yum China (YUMC US, TP USD58.00, CMP USD51.48 Buy)

As the dominant player in the western QSR segment in China, we believe Yum China will continue to deliver stable growth through penetration into lower tier cities and growth in its delivery business. We expect Yum China to deliver a 13% CAGR in net profit on a 9% CAGR in revenue over 2019-22e, with its KFC brand growing at CAGRs of 11% and 15% in terms of revenue and restaurant profit. We reiterate our Buy rating based on unchanged target price of USD58.0, implying an 11.7x 2021e EV/EBITDA vs an average 10.2x EV/EBITDA (range 7.3-16.1x) since the IPO in 2016. For our latest views on the stock, please see *Yum China – Buy: HSBC 2020 China Conference Highlights,* 13 May 2020.

Figure 7. HSBC target price potential upside/downside, consensus-based valuation



Source: Refinitiv, HSBC estimates (latest pricing date 9 July 2020)

Two pathways to scalability

- We compare the different growth paths Haidilao and Tai Er (part of JMJ) are taking
- Haidilao relies on its coaching system and scaling up the full supply chain through its related companies
- Tai Er uses standardisation and the quick service restaurant model to target young, aspirational female consumers

Taking different paths to growth

The pace of consolidation in the catering industry has been glacial

Unlike many other consumer markets in China, the pace of consolidation in the catering industry has been glacial. Self-operated chain restaurants accounted for only 4% of overall restaurant revenue in 2019. As we noted in our Yum China initiation report (*Fast food, even faster growth*, 2 November 2019), there is intense competition at every price point and we see three major bottlenecks that prevent companies from growing:

- **Brand awareness**

  Even Haidilao, the market leader with sales of RMB25.6bn, had less than 1% share in the Chinese cuisine market in 2019. It is difficult to break through regional barriers to build brand awareness in new markets in different parts of the country. Less brand awareness translates into lower table turnover and longer breakeven periods.

- **Scalability of the supply chain**

  The supply chain for operating a large restaurant chain is extremely long, covering site selection, design, construction, staff training, raw material sourcing, and hiring chefs as well as adapting to local tastes and in-store experiences. The operator needs to scale up each part of the value chain, which is usually complicated by the number of people involved and the divergence in the types of expertise required.

- **Availability of capital**

  The brands under discussion in this report have much better financial metrics than the industry as a whole. At the industry level, the typical breakeven period is 15-20 months (source: Frost & Sullivan). Given the fast changing tastes of Chinese consumers, without the support of the capital market, restaurants have to rely on the franchising model to achieve fast expansion, which can lead to a deterioration in quality and waning popularity.

In this chapter, we compare how Haidilao and Tai Er, which is part of Jiumaojiu, have taken different paths to grow their businesses. In our view, both are success stories.

Brand awareness

We believe there are three ways to tackle the brand awareness issue: word-of-mouth, location, and viral social media (Instagram (IG) value). In the table below, we compare the different strategies adopted by Haidilao and Tai Er.

Figure 8. Brand awareness

	Haidilao	Tai Er
Word-of-mouth	Provide well-rounded service to customers, KPIs focus on delivering customer satisfaction	"Good taste" and "good look" come first, KPIs focus on customer experience, store managers need to meet certain standards in terms of appearance
Location	No need to be at the best locations in shopping malls, but new stores require locations where they can be open for 24 hours a day	The best location in shopping malls
Viral social media (IG-value)	Good for social gatherings (e.g., birthday parties)	High IG-value

Source: HSBC

Different strategies lead to different financial results and store economics. Below we compare some key restaurant metrics, such as store size, table turnover and average number of customers per staff.

Because Haidilao stores are not usually located in prime locations in shopping malls, they are generally larger. Their long operating hours and reputation for top-tier service help draw traffic, as reflected by the impressive 5.2x table turnover at the same store level. However, this comes with a higher staff cost ratio (as a percentage of sales), 30.7% in 2019 vs 19.7% for Tai Er.

Tai Er normally pays for the best location in a shopping mall. This means traffic ramp-up is quick and the high table turnover of 5.1x reflects the popularity of the signature dish (sauerkraut fish) and the in-store ambience. The downside is a higher rental cost ratio (as a percentage of sales), 11.3% in 2019 vs 4.2% for Haidilao.

Figure 9. Key metrics for Haidilao and Tai Er (2019)

	Haidilao	Tai Er
Size of store (sqm)	**1,000**	**250**
- dining area	700	180
Number of seats (excl private rooms)	420	110
Same store table turn (x)	**5.2**	**5.1**
Daily customers served	1,192	507
Average spending per customer (RMB)	92	75
Rental cost ratio	**4.2%**	**11.3%**
Staff cost ratio	**30.7%**	**19.7%**
Operating hours per day (hours)	**24**	**8**
Number of staff	**150**	**30**
Number of guests per staff	**7.9**	**16.9**

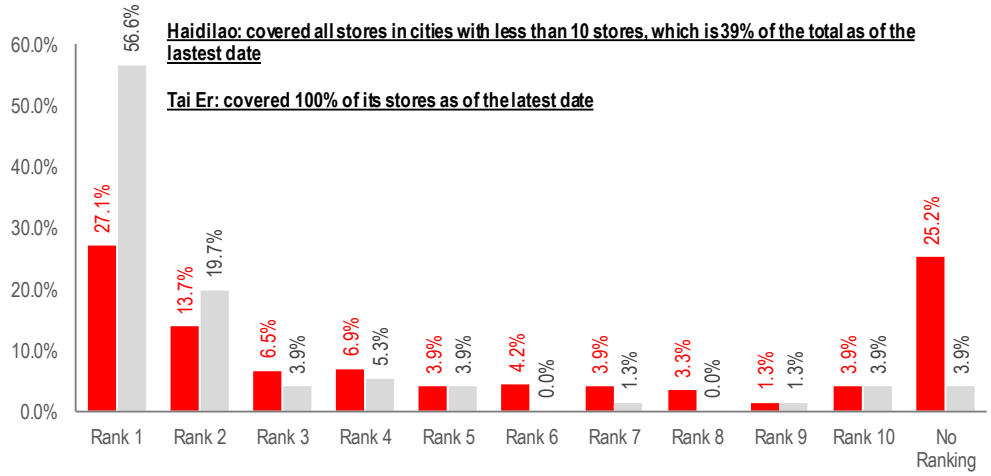
Source: Company data, HSBC

These differences are confirmed by reviews of individual restaurants on the popular Dianping app. Figure 10 shows the results for all Haidilao restaurants in cities with less than 10 stores and all Tai Er stores. The stores we surveyed cover 39% of all Haidilao stores. We think this is most relevant as it shows how important “taste” is to Haidilao in terms of expanding into new regions or deepening penetration in markets with fewer stores.

The rankings are from 1-10: 1 means it was ranked No. 1 by customers in the category within the catchment area; 10 means it was ranked No. 10. All rankings lower than 10 are categorised under “no ranking”.

- 57% of Tai Er restaurants are ranked No. 1 vs 27% for Haidilao.
- 4% of Tai Er restaurants have “no ranking” vs 25% for Haidilao.

Figure 10. Dianping rankings of Haidilao and Tai Er restaurants



Source: Dianping, HSBC (as of June 2020)

This helps answer one of the most common push backs on Haidilao: It does not aim to compete with “more authentic” local hot pot restaurants. The focus is on providing the best service and good food.

Scalability of the supply chain

Once the traffic issue at an individual restaurant level is resolved, the next problem is how to replicate the success consistently across the whole chain. Again, the value chain for cross-regional expansion is very long, covering site selection, design, training, sourcing raw materials, and adapting to local tastes. In Figure 11, we compare the different strategies adopted by Haidilao and Tai Er.

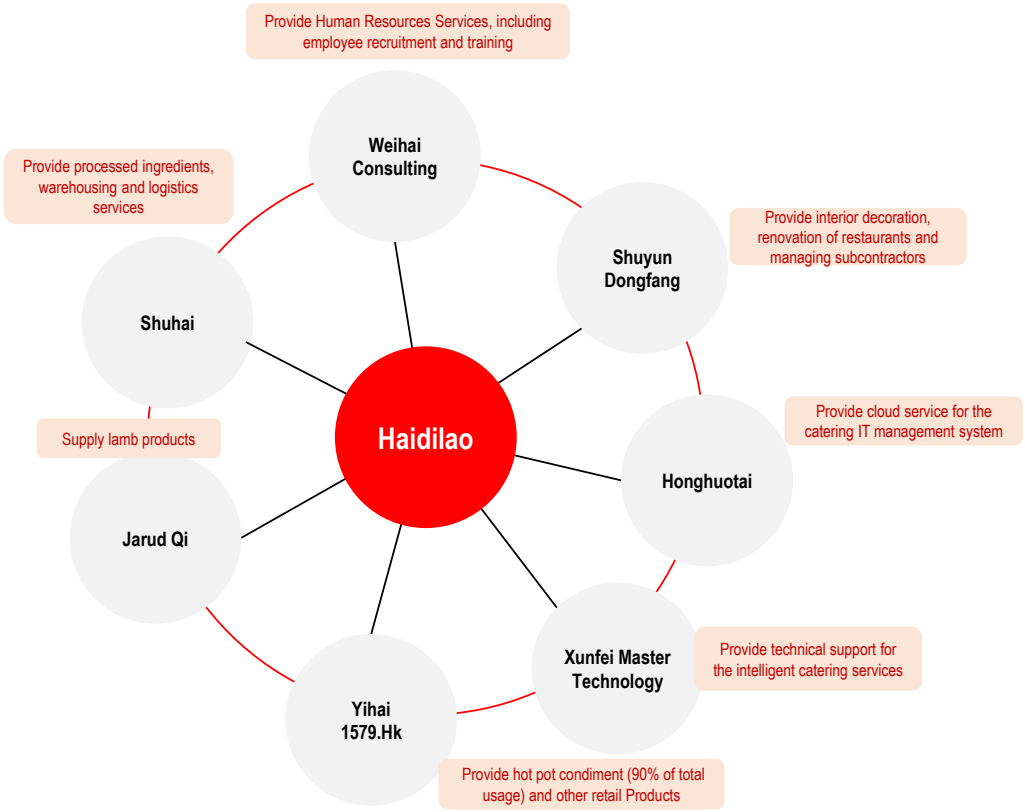
Figure 11. Scalability of the supply chain

	Haidilao	Tai Er
Ecosystem	Seven related companies provide support to the full value chain: from IT, HR, sourcing, warehousing & logistics to project construction	Use authorised suppliers and generally only cooperate with major suppliers for key food ingredients
Coaching system	Unique coaching system and mentor-to-mentee relationship to incubate talent	Try to centralise all the key functions to minimise preparation and reduce the complexity of work at the restaurant level (QSR model adopted for full-service restaurants)
Focus	Target all customers, but the focus is on young females (aged 26-35)	Traditional dish that is popular with young female consumers shopping in malls
Stock keeping units (SKUs)	100x	1x (spicy fish) + 23x

Source: HSBC

As discussed earlier, Haidilao stores are larger, have more employees and over 100 stock keeping units (SKUs) covering the dishes on the menu. Maintaining a consistently high level of service, food safety and flavour across regions is a complex challenge. Haidilao has resolved the problem by developing its own ecosystem through seven related parties which provide a range of services, including HR & training, project management, IT services, smart technology, hot pot condiments, raw material sourcing, processed ingredients, warehousing and logistics.

Figure 12. The Haidilao ecosystem of related companies (since IPO)


Provide Human Resources Services, including employee recruitment and training
Weihai Consulting
Provide processed ingredients, warehousing and logistics services
Shuyun Dongfang
Provide interior decoration, renovation of restaurants and managing subcontractors
Shuhai
Haidilao
Supply lamb products
Provide cloud service for the catering IT management system
Honghuotai
Jarud Qi
Xunfei Master Technology
Provide technical support for the intelligent catering services
Yihai 1579.Hk
Provide hot pot condiment (90% of total usage) and other retail Products

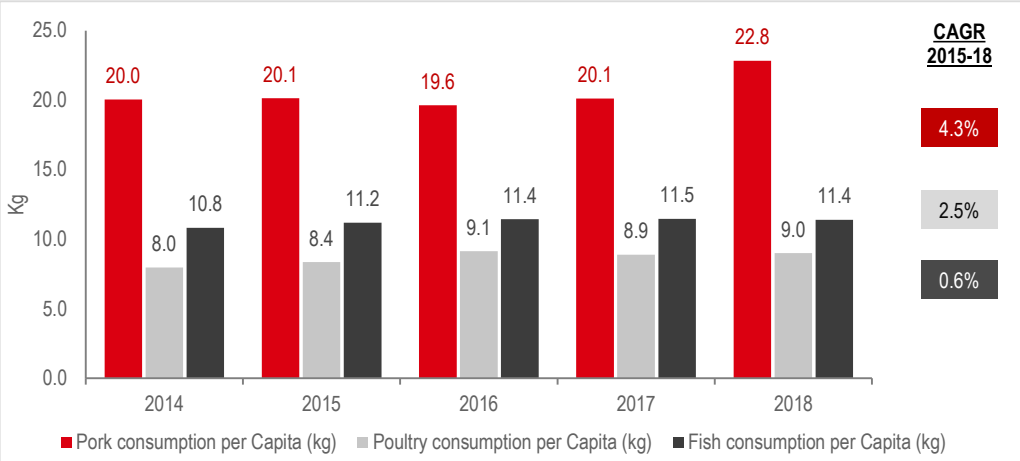
Source: Company data, HSBC

Tai Er takes a more minimalist approach. It has only 24 SKUs, one being the signature spicy fish dish, which is offered in three sizes. It takes great efforts to standardise the taste and preparation of the main dish. Other dishes are mostly prepared in an external central kitchen, easing the work load on the restaurant kitchen.

There are three main reasons why sauerkraut fish was selected as the main dish. The first is related to the dietary habits of Chinese diners. As shown in Figure 13, the per capita consumption of fish is well below that of pork as fish is not a daily dish for most households outside southern China. Fish makes a nice change. The second reason is that sauerkraut fish is a Sichuan dish, the second largest type of cuisine in the domestic market after hot pot. Lastly, it is easier to standardise than most dishes in Cantonese cuisine, where chefs tend to play a larger role.

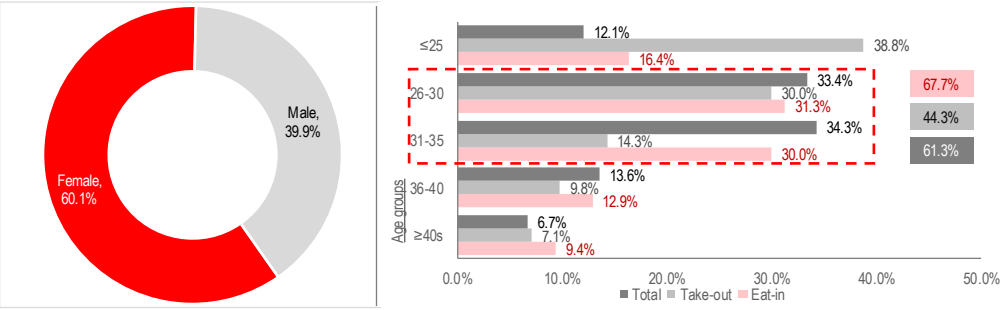
Another factor to consider is demographics. Tai Er specifically targets young (26-35 years), female customers in shopping malls, who are enthusiastic consumers of this type of cuisine. They accounted for 68% of dine-in revenue in the sauerkraut fish restaurant segment in China.

Figure 13. Per capita protein consumption (kg)



Source: NBS

Figure 14. Sauerkraut fish consumption by gender and age group (2019)



Source: Meituan

Availability of capital

The limited availability of capital is often another important deterrent to building scale. This is no longer a problem for Haidilao and Tai Er post their IPOs. As shown in Figure 15, Haidilao's store numbers have grown to 768 since the IPO in September 2018. For Tai Er, which was only listed in January 2020, its IPO proceeds can support the opening of 703 new restaurants vs the total store count of 336 at the end of 2019.

This is far from the industry norm. The average cash payback period is 15-20 months (source: Frost & Sullivan) and most restaurant operators find it difficult to scale up based on self-generated returns, especially given the fast-changing preferences of Chinese consumers. That is why most chain restaurants use the franchising model to expand as it reduces the need to use their own capital.

Figure 15. Availability of capital (RMBm)

	Haidilao	Tai Er
IPO proceeds	6,083	1,868
- IPO date	26-Sep-18	15-Jan-20
Number of stores prior to IPO	362	336
Number of stores opened post IPO	406	na
- Capex per POS (RMBm)	10	2.5
IPO proceeds budgeted for IT and central kitchens, repay of loans	2,129	307
Remaining proceeds for store expansion	0	1,756
- equivalent number of stores	0	703

Source: Company data, HSBC

Conclusion and implications

There is no right or wrong strategy but each has different implications for the sustainability of the business model, growth and margins of Haidilao and Tai Er. See Figure 16.

Figure 16. Risk assessment of different strategies

	Haidilao	Tai Er
Brand awareness		
Word-of-mouth	Low risk	Risk of copycats
Location	Low risk: good service generates traffic -> strong bargaining power with landlords	Low risk: oversupply of shopping malls, and a low base for store expansion
Viral social media (IG-value)	Low risk	Dining trend risk
Scalability of the supply chain		
Ecosystem	Related companies might not match the pace of expansion of the company or deliver the desired financial results	Weaker control over the suppliers, but can be compensated by rigorous internal and third-party auditing mechanisms
Coaching system	A vicious cycle during the growth stage, and the effect diminishes as growth decelerates	Low risk, less reliance on in-store staff
Focus	More complex supply chain	Fewer SKUs, smaller store size; targeting groups of 2-4 customers minimizes the complexity of the supply chain
	Low dining trend risk	Embedded dining trend risk, but still at the early stage of growth within its niche segment

Source: HSBC

We think Haidilao's strategy is very sound, with two caveats:

- **Related companies move out of sync:**

  The related companies in the supply chain might not match the pace of expansion or deliver the desired financial results.

- **The positive correlation between growth and incentives:**

  We believe its unique talent incubation mechanism (detailed in the next chapter) creates a vicious cycle when growth accelerates and the positive effects diminish as growth decelerates.

For Tai Er, the shortcomings of its minimalist approach are apparent to us:

- **Dining trend risk**

  The dining trend risk may not currently be a big concern as the sauerkraut fish restaurant concept is still in the fast growth phase (see chapter on "The Chinese cuisine catering industry").

- **Entry barriers might not be so low**

In Figure 17, we list the top-10 sauerkraut fish restaurant chains in China. Tai Er has three direct competitors – Jiu Guo Yi Tang, Yao, and Jiang Yu Er.

Figure 17. 2019 Top-10 sauerkraut fish brands

Brand (English)	Brand (Chinese)	Year of launch	Location	Type of market	Store and product features	POS count (2019)
Full service, targets young customers, uses live fish						
Tai Er	太二酸菜鱼	2015	Guangzhou	Casual dining	Young customers, does not accept groups >4 people or single customers; only 3 portion sizes for fish dish	126
Jiu Guo Yi Tang	九锅一堂	2010	Chongqing	Casual dining	Small portions, healthy dining and uses bottled water to make the sauerkraut fish soup	101-200
Jiang Yu Er	江渔儿	2015	Guangzhou	Casual dining	Focus on local communities, mass market, target groups of all sizes and single customers	200+
Yao	姚酸菜鱼	2016	Shenzhen	Casual dining	Tiffany blue store colour design, caters for female customers	~20
Chinese QSR, uses frozen fish						
Yu Ni Zai Yi Qi	鱼你在一起	2017	Beijing	QSR	Individual servings and serving within 5 min	>1,000
Yu Shi Hu	渝是乎	2015	Beijing	QSR	Interior design, focus on sauerkraut small fish	51-100
Full service, traditional style						
You Jia Suan Cai Yu	有家酸菜鱼	2013	Suzhou	Casual dining	Master chef cooking with live fish and strong local flavour	51-100
Wang Rong Cheng	望蓉城	2016	Shanghai	Casual dining	Premium Sichuan restaurant featuring sauerkraut fish	<20
Yan Chu Lao Tan	严厨老坛	2014	Suzhou	Casual dining	Live fish for cooking, selling-points are freshness and chef's knife skills	>200
Lu Ding Ji	禄鼎记	2012	Guangzhou	Casual dining	Store features the image of the God of Fortune, selling-points are food safety and Chinese folklore style	<20

Source: Meituan, HSBC

In Figure 18, we compare operating models and the cost of investment (COI) per store. Limited by capital, the other three brands have all adopted a franchising model; only Tai Er has self-operated restaurants. The COI ranges from RMB250,000 to RMB1m vs RMB2.5m for Tai Er. Given the similar price category and positioning, we believe Jiu Mao Jiu's successful IPO has set it apart from its peer group and put it in a strong position to accelerate growth.

Figure 18. The brands competing with Tai Er

	Business model	Cost of investment per store (RMBm)
Jiu Guo Yi Tang	Direct & franchising	0.25
Yao	Direct & franchising	0.5-1
Jiang Yu Er	Direct & franchising	0.25
Tai Er	**Direct-operating**	**2.5**

Source: Company data, HSBC

Finding the ceiling for Haidilao

- We use two approaches to estimate the maximum number of hot pot restaurants Haidilao can open in mainland China beyond 2023e
- Our range is 2,027 to 2,714 restaurants vs a consensus estimate of 1,868 by 2023e
- We also analyse why a deceleration in the pace of Haidilao's expansion has implications for margins and valuation

Penetration growth vs valuation

The market has rewarded Haidilao with a premium valuation

The market has rewarded Haidilao with a premium valuation for its potential to increase market share through expansion. There is no doubt the company has done a commendable job since the IPO in 2018. It has more than doubled the number of stores in mainland China and deepened the penetration rate of the chain's national footprint.

Just over half its stores (51%) are now in markets with more than 50 stores per province or municipality vs 0% at the time of the IPO. Only 6% are in markets with less than 11 stores per province or municipality vs 20% at the time of IPO.

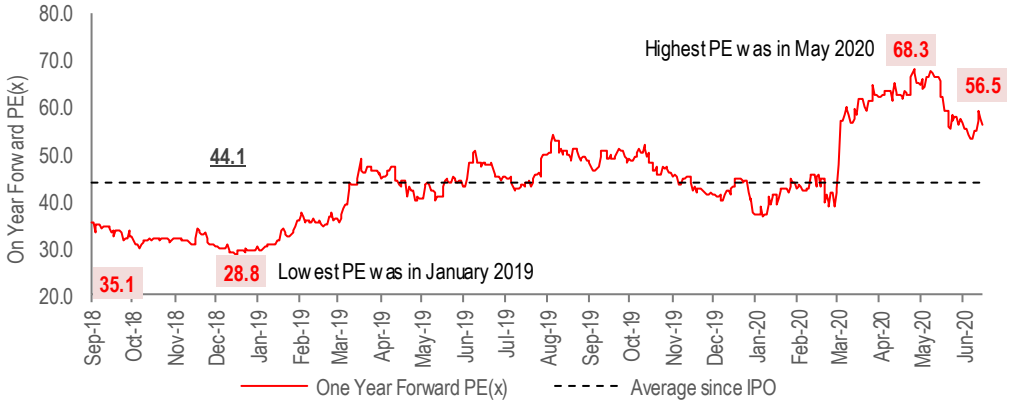
Figure 19. Store density by province or municipality in mainland China

	at IPO		6/12/2020	
	No. of POS	% of total	No. of POS	% of total
More than 50	0	0%	394	51%
Between 31-50	82	25%	132	17%
Between 21-30	102	31%	54	7%
Between 11-20	80	24%	149	19%
Less than 11	67	20%	47	6%
Total	**331**	**100%**	**776**	**100%**

Source: Company data. HSBC

The market has rewarded this rapid pace of expansion. Haidilao's one-year forward PE at the time of IPO was 35x, it reached a peak of 68x in May 2020 and now trades at a PE of 56.5x on 2021e consensus EPS. To put that into perspective, the stocks of full-service Chinese restaurant companies trade at an average PE of 29x on 2021e consensus EPS.

Figure 20. Haidilao 1-year forward PE chart since IPO



Source: Bloomberg

Finding the ceiling

Here we try to find out where the ceiling is in terms of Haidilao's store expansion and then compare the result with market consensus. We use two metrics:

- **Market share by province:** We first estimate the potential maximum market share in the respective catering market in the Big 4 cities (Beijing, Shanghai, Guangzhou, Shenzhen) after reaching a penetration rate of one restaurant per 250,000 people. Then, we benchmark the potential market share in all provinces to the level in the Big 4 cities, capped at a maximum penetration of one store per 350,000 people in all provinces.
- **Population penetration by city:** We categorise its stores by city groups based on the size of the urban population per store, and then assume a maximum penetration per city group to derive the maximum number of stores the company can open.

Market share by province

First, we assume that in Big 4 cities Haidilao's store penetration will reach a saturation point after one restaurant covers an urban population of 250,000. Management indicates it will open a new restaurant in locations with a population of at least 200,000 within a 3km radius.

This exercise gives us the potential maximum market share in the total catering service industry in Guangzhou, Shenzhen, Shanghai and Beijing of 2.0%, 2.7%, 3.6% and 3.2% respectively, up from 1.2%, 2.1%, 2.6%, 2.4% in 2019 (HSBC estimates).

Figure 21. Calibrating by market share by province

	6/12/2020			Scenario 1			Scenario 2		
	Urban population per POS ('000)	Local catering market share %	No. of POS	Urban population per POS ('000)	Local catering market share %	No. of POS	Urban population per POS ('000)	Local catering market share %	No. of POS
Big 4 cities									
Guangzhou	414	1.2%	32	250	2.0%	53	250	2.0%	53
Shenzhen	310	2.1%	42	250	2.7%	52	250	2.7%	52
Shanghai	342	2.6%	71	250	3.6%	97	250	3.6%	97
Beijing	327	2.4%	66	250	3.2%	86	250	3.2%	86
Sichuan	6,427	0.2%	13	2,397	0.5%	35	2,397	0.5%	35
Chongqing	7,767	0.1%	4	1,897	0.5%	16	1,897	0.5%	16
Other provinces	2,103	0.5%	548	>350	2.0%	1,710	>350	2.8%	2,374
Total	**1,726**	**0.6%**	**776**	**653**	**1.9%**	**2,050**	**493**	**2.5%**	**2,714**

Source: HSBC estimates

Then, we use two scenarios:

Scenario 1: We apply the lower end of the potential market share in the Big 4, which is 2.0% in Guangzhou and cap it with a maximum urban population penetration of 350,000. This gives us a maximum store count of 2,050.

Scenario 2: We apply the average potential market share in the Big 4 of 2.8% to all cities and cap it with a maximum urban population penetration of 350,000. This gives us a maximum store count of 2,714.

There are only two exceptions in terms of Haidilao's potential maximum market share – Sichuan and Chongqing. These two markets are the home of Sichuan hot pot and the local hot pot market is highly competitive. We assume their market share will be capped at 0.5%. The company has 13 restaurants in Sichuan and four in Chongqing.

By population penetration by cities

We categorise its stores into city groups based on the number of urban population covered by each restaurant

First, we categorise its stores into city groups by the number of urban population covered by each Haidilao restaurant in the city. We have four categories for population coverage per store: less than 300,000, 300,000-500,000, 600,000-1m and more than 1m.

Then, we assume the three categories below 1m-plus will all reach a maximum penetration of 200,000 urban population per store. The above 1m group will reach a maximum penetration of 350,000 urban population per store. Again, we cap the penetration in Chongqing and Chengdu, Sichuan, to 1m and 500,000 urban population per restaurant. This exercise gives us a maximum store count of 2,027.

There is a caveat to these findings. It only covers the 130 cities Haidilao has a presence in, covering a population of 532m, about 62% of the total urban population in mainland China. If we assume the company will enter more cities and reach a penetration rate of 500,000 urban population per restaurant, the maximum store count in mainland China would then be 2,678.

Figure 22. Population penetration by cities

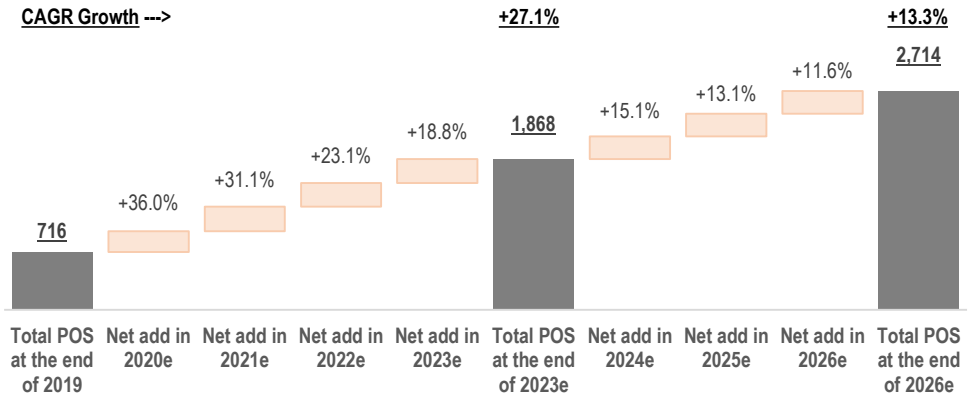
Population per restaurant	Number of stores		Weighted average urban population per POS		Average number of stores per city	
	6/12/2020	Target	6/12/2020	Target	6/12/2020	Target
Existing cities covered						
<300k	145	179	245,457	199,339	21	26
300k-500k	291	540	371,131	200,000	18	34
600k-1m	191	639	668,784	200,000	5	16
>1m	149	670	1,689,004	375,783	2	10
Subtotal	**776**	**2,027**	**673,956**	**258,021**	**6**	**16**
Potential new cities						
500k	0	651		500,000		
Total		**2,678**		**316,837**		

Source: HSBC estimates

Reconciling our estimates with consensus

According to Visible Alpha, consensus expects the store count to rise to 1,868 in mainland China in 2023e, with restaurant revenue increasing to RMB73.781bn. In 2019, Haidilao had 716 stores and restaurant revenue of RMB23.403bn, implying a revenue CAGR of 33%. Our estimates suggest a range of between 2,027 and 2,714 restaurants. The low end is in line with the consensus estimate in 2023e, while the high end is 30% above. In Figure 23, we illustrate how the growth in store opening will decelerate after it surpasses the consensus store expectation of 1,868 restaurants in mainland China by 2023e.

Figure 23. Blue sky scenario for store growth in mainland China post 2023e



Source: HSBC estimates, Visible Alpha

We can cross check these estimates by using Frost & Sullivan's estimates for the catering industry market. Consensus revenue forecasts suggest Haidilao will take 12% of the total market share gain of all chain restaurants over 2019-23e. This is double the amount Haidilao achieved over 2015-19.

Using Frost & Sullivan's forecast for the size of the hot pot market in mainland China, consensus suggests Haidilao's market share in this segment will grow to 9.4% in 2023e, up from 4.5% in 2019. According to iiMedia, Sichuan style hot pot is 64.2% of the total hot pot market, meaning Haidilao's share in the Sichuan flavoured hot pot segment would go up to 15% by 2023e, based on market consensus. This would represent a considerable achievement, given the highly fragmented nature of the catering industry.

Implications for Haidilao's talent incubating system

One of its current strengths could become a weakness

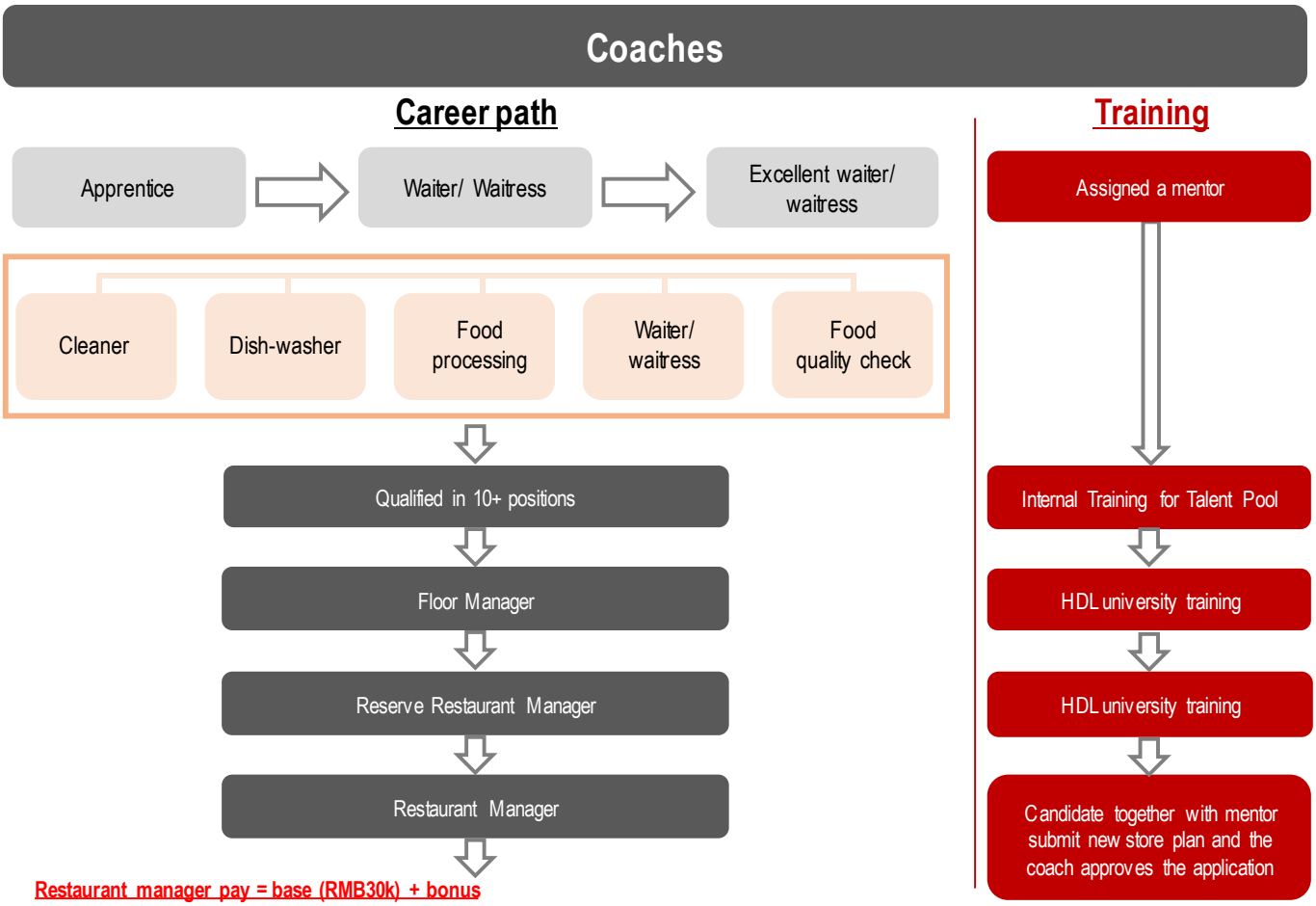
The weight of market expectations is not the only risk facing Haidilao. In our view, one of its current strengths could become a weakness as its growth starts to decelerate. In the previous chapter, we discussed how Haidilao expanded by building an ecosystem through its related companies. This covers the full restaurant value chain and uses differentiated services (such as free manicures, keeping your beverage at a certain height with frequent refills) to attract traffic and generate high table turnover.

But in our view the main differentiator has been its coaching system. This unique mentor-to-mentee talent incubation system has helped to resolve many of the problems that plague the restaurant industry in China – high staff turnover and the difficulty of maintaining the same level of service throughout a large chain. All the restaurant managers are products of this coaching programme. We discuss later how the deceleration of its pace of store expansion will have a negative impact on this incentive system. But first, a quick recap on its coaching system.

Haidilao's coaching system

Zhang Yong, the founder, told *Forbes* magazine in January 2019 that: "Putting faith in my staff has paid off for me. Giving them responsibility and autonomy is how you show trust." This approach is reflected in the company's mentor and incentive scheme. The company rewards its managers with a percentage of the restaurant's profits. Each employee joining Haidilao is assigned a mentor, has a clear path to promotion and is given the required training needed to reach the ultimate goal of becoming a store manager. A mentee who has graduated to the pool of store manager candidates is then in line to apply to run a new location. If successful, the mentor and mentee store manager will both get a cut of the profits from the new restaurant.

Figure 24. Haidilao's talent incubation system



Restaurant manager pay = base (RMB30k) + bonus

Bonus scheme

i）0.4% of the profits of the restaurant that he/she manages;

ii）3.1% of the profits of the restaurants that his/her first-generation mentees manage;

iii）1.5% of the profits of the restaurants that his/her second-generation mentees manage.

Example of the total compensation for a mentor that has 1 mentee store:

Base: RMB 30k x 12 = **360K**

His / her own store profit sharing: RMB**24k = 0.4% * [Revenue 40m * 20% restaurant margin * (1-25% tax)]**

His / her mentee store profit sharing: RMB**186k = 3.1% * [Revenue 40m * 20% restaurant margin * (1-25% tax)]**

Total: RMB 570k

Source: Company reports, HSBC

At the entry level, pay is not much higher than the industry average but there is an incentive scheme based on workload. The real rewards come with promotion to store manager – the base pay is 3x the industry average. On top of that, a store manager gets a share of the profits – 0.4% in its own store, 3.1% in the first-generation mentee's store and 1.5% in its second generation mentee's store. We see two merits to the system:

- Encouragement of best practices at reasonable cost

  The core of Haidilao's brand equity is its reputation for service, which generates the 5x table turnover rate that is well-above industry average. The incentive schemes ensure retained employees deliver best practices and the restaurants do not have to pay them excessively before they step up to the store manager level.

- Effective incubation of talent for opening new stores

  Once an employee becomes a store manager, they have every incentive to train juniors and eventually to open their own stores. The mentor store managers are better rewarded by opening more next-generation restaurants. In reward, all mentor-mentees in the network need to work together to help the mentor store keep an A rating under Haidilao's monthly A-E review system based on customer satisfaction.

Negative incentives as growth decelerates

As Haidilao has expanding rapidly there has been a shortage of qualified store managers. This means the success rate of new stores is high and the rewards generous. However, as the growth rate decelerates, the probability of promotion will also diminish.

Let's illustrate this with some examples. The pool of store manager candidates reached 1,300 at end-2019 (vs c1,000 estimated store openings in the next three years), up from only 200 at the time of the IPO

The promotion rate from managerial staff to store manager candidate is 28%

In 2018-19, there were a total of 570 newly graduated managerial staff, in addition to the 3,665 managerial staff at the time of the IPO. At the end of 2019, there was a net addition of 500 store manager candidates, taking the total to 1,300 from 800 at the end of 2018. The company also opened 324 new stores in 2019. From this, we can calculate the promotion rate from managerial staff to store manager candidate:

= (1,300 – 800 + 324) / (570 + 3,665 – 1,300) = 28%

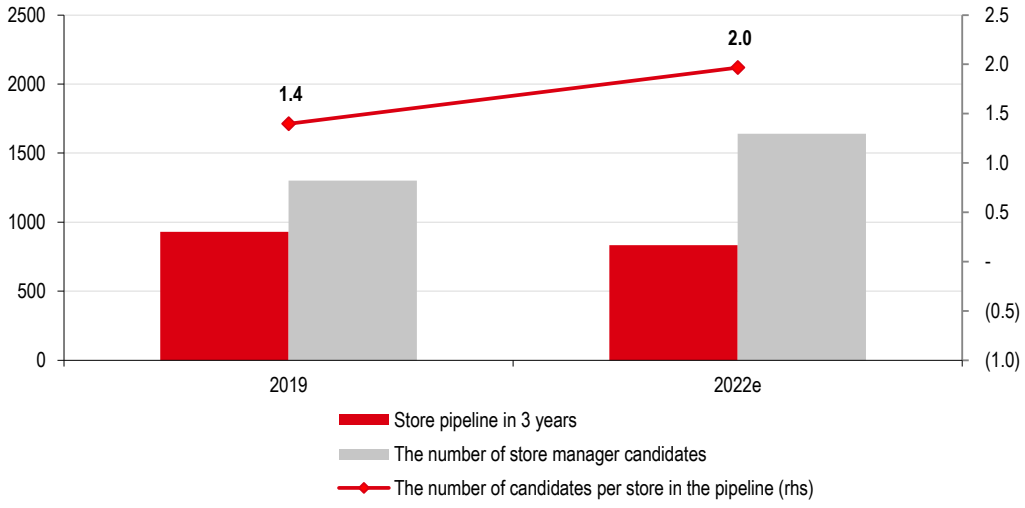
The pool of store manager candidates will go up to 1,640 by the end of 2022

If we assume the same 28% promotion rate, and then factor in 930 new stores opening over 2020-22, the pool of store manager candidates will go up to 1,640 by the end of 2022.

= (570 + 3,665 – 1,300 + 980 + 2,000 + 3,240) * 28% - 930 = 1,640

As a result, for each store in the pipeline, there will be two store manager candidates at the end of 2022e vs 1.4 at the end of 2019, a 41% increase.

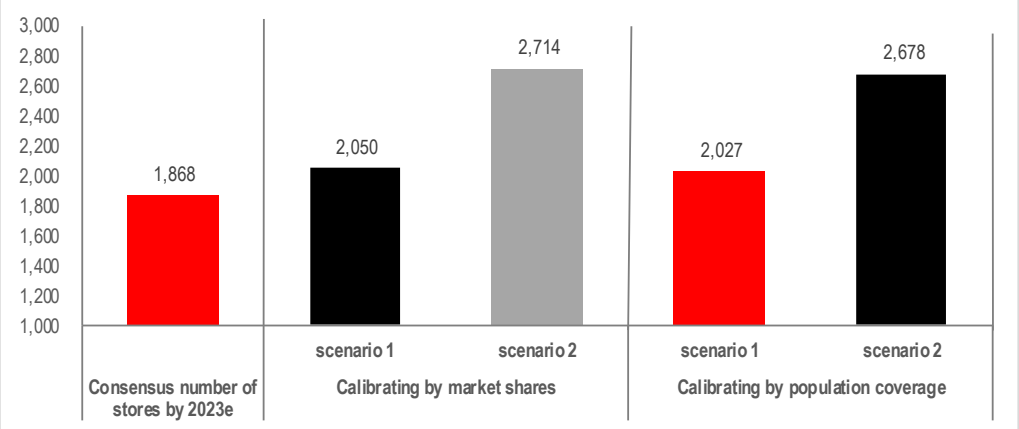
Figure 25. The average number of store manager candidates per store in the pipeline



Source: HSBC estimates

There will be a knock-on effect on the chain of promotion

Figure 26. The maximum store expansion potential for Haidilao vs consensus in 2023e



Source: HSBC estimates, Visible Alpha

This means that not only will there be less chance of becoming a store manager but also that there will be a knock-on effect on the chain of promotion from apprentice to managerial staff and then store manager candidates and the related financial incentives. This system has helped create the core brand value of Haidilao – high quality service at a reasonable cost.

Conclusion

We reach two main conclusions in this chapter:

- We estimate Haidilao will have a maximum potential to open between 2,027 and 2,714 restaurants in mainland China vs the consensus estimate of reaching 1,868 restaurants by 2023e.
- Deceleration in its pace of store expansion will have negative implications for its current business model, especially in relation to its talent incubation system. We expect the benefits from the incentive scheme to gradually diminish as the pace of expansion slows.

In summary, not only do we think that market expectations about the company's growth potential are fully priced in, we also believe there are potential risks to margins as the benefits of the incentive scheme start to fade.

Peer comparison

- We compare the Chinese cuisine peer group on key financial metrics
- Thanks to fast table turnover, Haidilao and Tai Er stand out in terms of productivity and margins
- The type of business strategy used is a major differentiator in terms of their financial results

Benchmarking the peer group

In this chapter we provide a comparison for the Chinese cuisine peer group:

- **Full-service hot pot restaurants**: Haidilao (HDL) and Xiabu Xiabu (0520 HK)
- **Full-service Chinese cuisine restaurants**: The Tai Er and Jiumaojiu brands under JMJ
- **Western QSR**: KFC and Pizza Hut under Yum China

Snapshot

Figure 27 provides a snapshot of the peer group, highlighting some key differences. For example, as discussed earlier, Haidilao operates large premises which are not usually located in the prime locations of a shopping mall. As a result, its unit sales per store are the highest among the peer group and its lease cost ratio the lowest.

Tai Er uses prime mall locations to generate traffic so the lease cost ratio is higher (11.3%) although it is still lower than Xiabu Xiabu's 14.7% thanks to much higher sales productivity per restaurant.

For Jiumaojiu, the lease cost ratio is similar to that of Tai Er. However, if we calculate the cost ratio based on revenue that includes deliveries, its lease cost ratio declines to 8.5%.

In the following sections, we compare more detailed operational matrixes of the Chinese cuisine peer group.

Figure 27. Peer group comparison (2019)

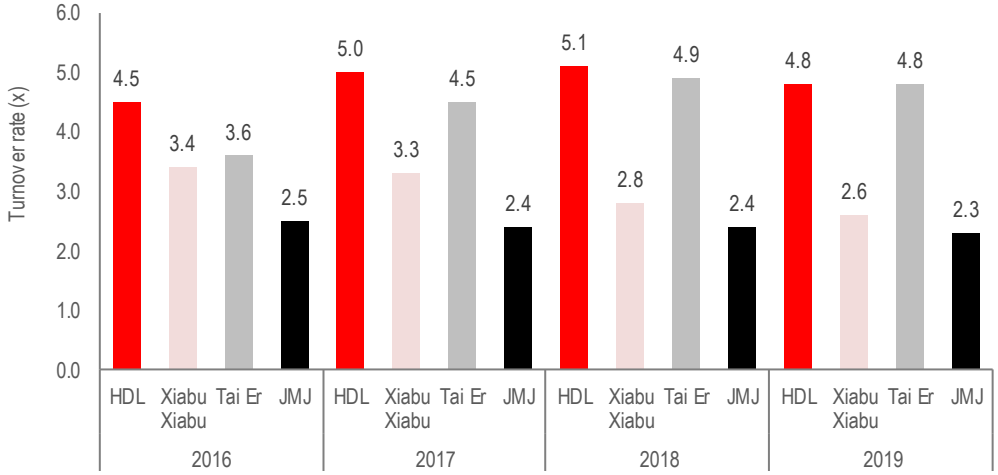
	Western QSR		Full-service hot pot		Full-service Chinese cuisine	
	KFC	Pizza Hut	Haidilao	Xiabu Xiabu	Tai Er	Jiumaojiu
Pre-tax cash payback period (months)	**24**	**36-48**	**8-15**	**17-18**	**7**	**22**
Initial monthly breakeven period (months)	NA	NA	1-3	3	1-2	1-2
Average unit sales productivity for same store (RMBm pa)	**6.0**	**5.3**	**51.0**	**4.4**	**14.3**	**9.5**
- Store area (sqm)	300	300-500	1000	400	250	350
Restaurant margins (IFRS 16 adjusted)*, incl. DA	**17.8%**	**11.1%**	**14.6%**	**11.9%**	**21.5%**	**16.0%**
Food GPM (% of rev)	68.6%	69.0%	57.8%	64.0%	59.1%	67.0%
Staff cost ratio (% of rev)	-21.3%	-26.8%	-30.7%	-26.3%	-19.7%	-31.9%
Lease cost ratio (% of rev)*	-9.9%	-9.9%	-4.2%	-14.7%	-11.3%	-8.5%
Licensing cost ratio (% of rev)	-3.0%	-3.0%	0.0%	0.0%	0.0%	0.0%
Depreciation & amortisation cost ratio (% of Rev)*	-5.0%	-5.9%	-4.8%	-5.5%	-3.0%	-4.2%
Other opex ratio (% of rev): utilities, marketing, delivery	-11.6%	-12.4%	-3.5%	-5.5%	-3.6%	-6.3%
Capex per store (RMBm)	**2.5**	**2.6**	**8-10**	**1.4**	**2.5**	**2.5**

Source: Company data, HSBC (*including delivery revenue)

Table turnover

Table turnover of Haidilao and Tai Er is the highest at c5x, almost double that of peers. It is the key contributor to their above-peer sales productivity per POS.

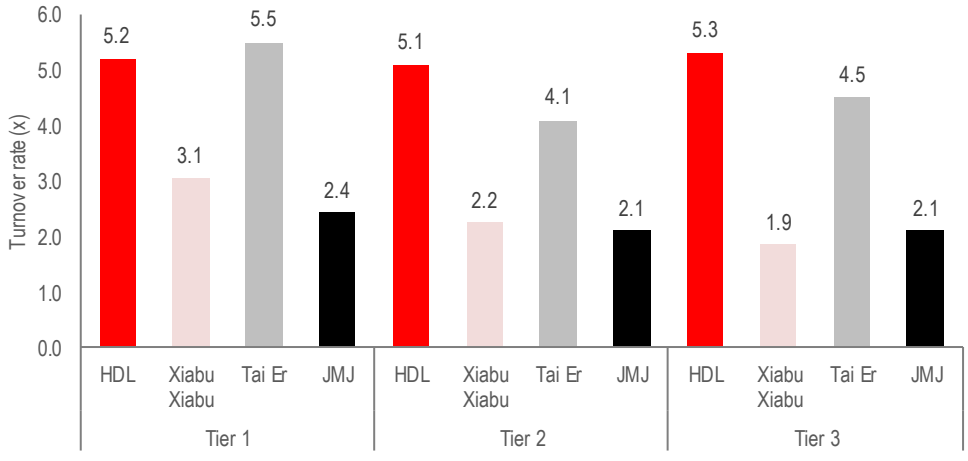
Figure 28. Overall table turnover (2016-19)



Source: Company data

As the overall table turnover might be diluted by the performance of newly opened restaurants, in Figure 29, we compare table turnover by city tier for their same-store sales. Haidilao and Tai Er's outperformance vs the peer group was consistent across city tiers, although it is generally weaker in tier 2 cities. This is likely due to the intense competition in tier 2 markets and relatively weaker spending power vs that in tier 1 cities.

Figure 29. Same-store table turnover by city tier (1H19)

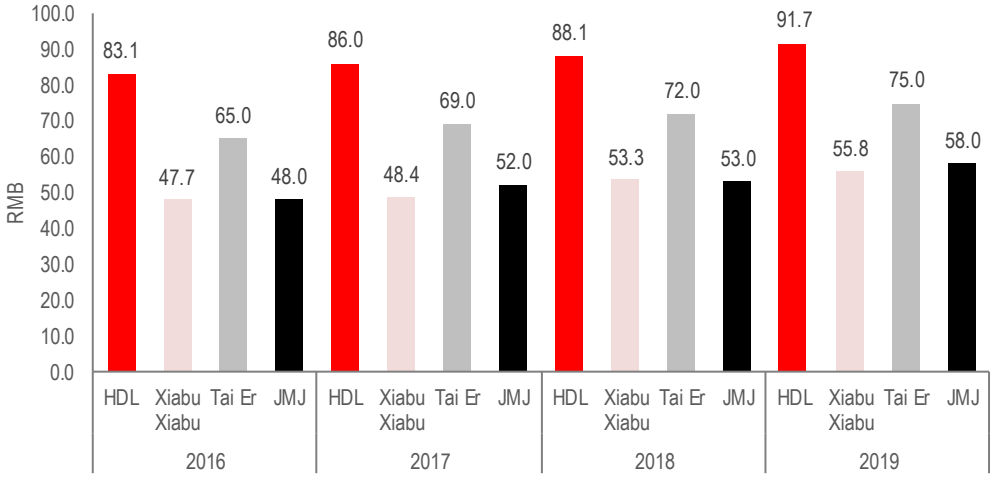


Source: Company data

Average spending per customer

In Figure 30, we compare the other key contributors to chain restaurants' sales productivity: the average spending per customer (ATK). As a rule of thumb, the ATK in shopping malls ranges from RMB80-120 for mid-to-high end restaurants. Haidilao's ATK is near the middle of this range and Tai Er's is at the low end.

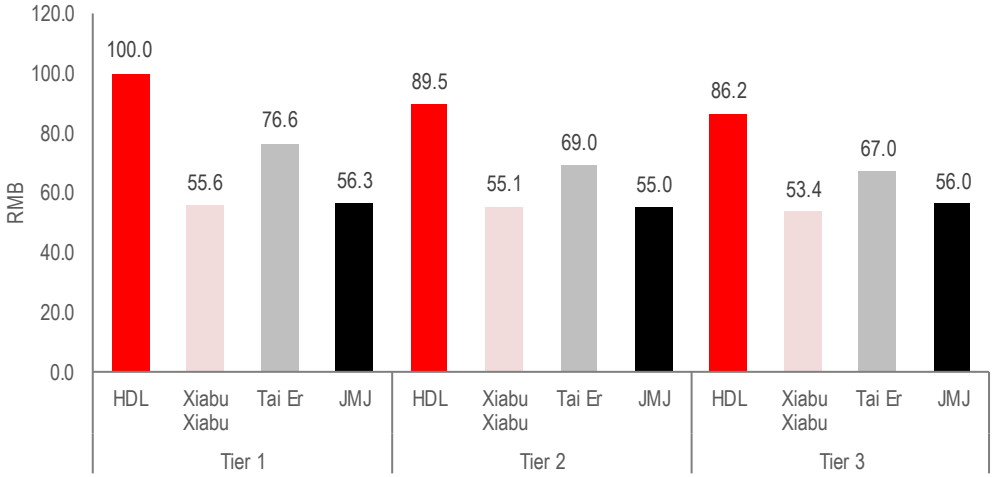
Figure 30. Average spending per customer (RMB, 2016-19)



Source: Company data (*adjusted the ATK to exclude VAT)

In Figure 31, we provide the ATK comparison across city tiers. For Haidilao and Tai Er, their ATK outside of Tier 1 cities are in general 10% lower. For more mass-market positioned Xiabu Xiabu and JMJ, the ATK is quite similar across city tiers.

Figure 31. Average spending per customer by city tier (RMB, 1H19)

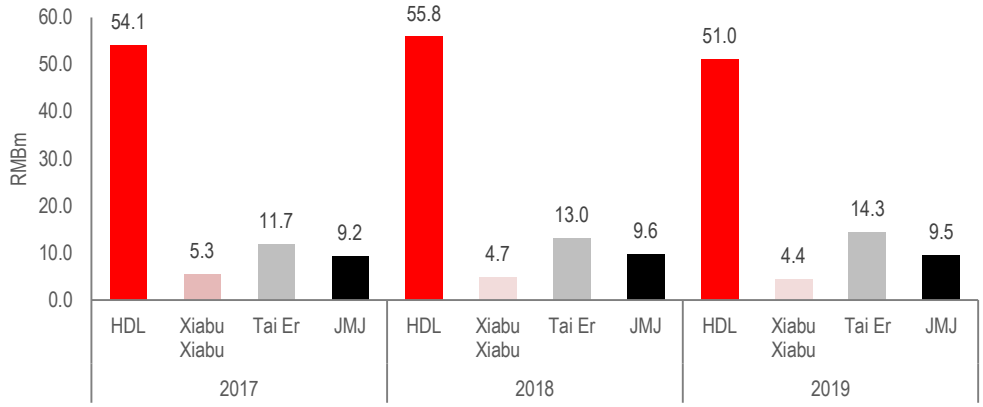


Source: Company data (*adjusted the ATK to exclude VAT)

Annual sales per restaurant

In Figure 32, we compare the annual sales per restaurant. Again, differences are the result of store size, ATK and table turnover.

Figure 32. Average annual sales per same store (RMBm)

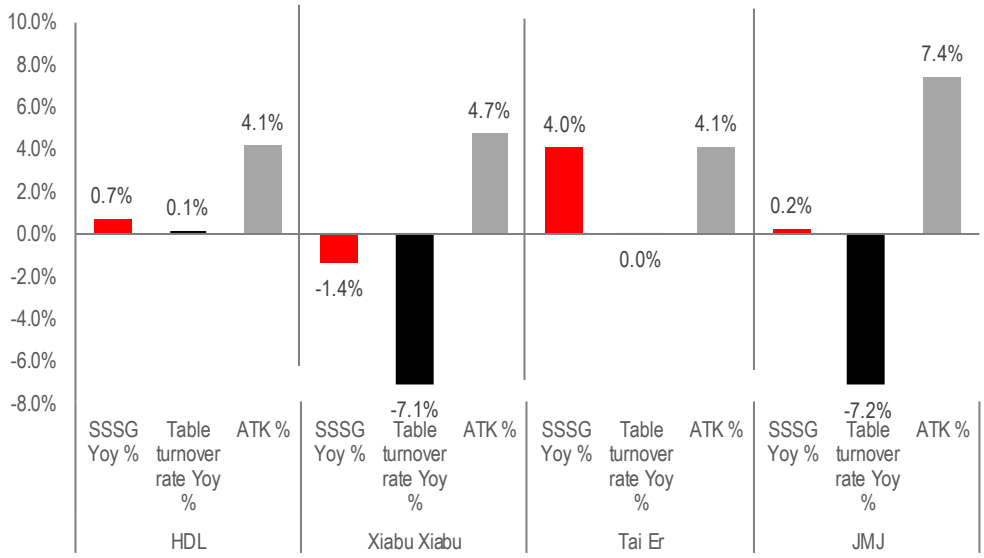


Source: Company data

Same-store sales growth (SSSG)

We now compare growth drivers starting with SSSG, which is primarily driven by ATK

Figure 33. SSSG drivers (2019)

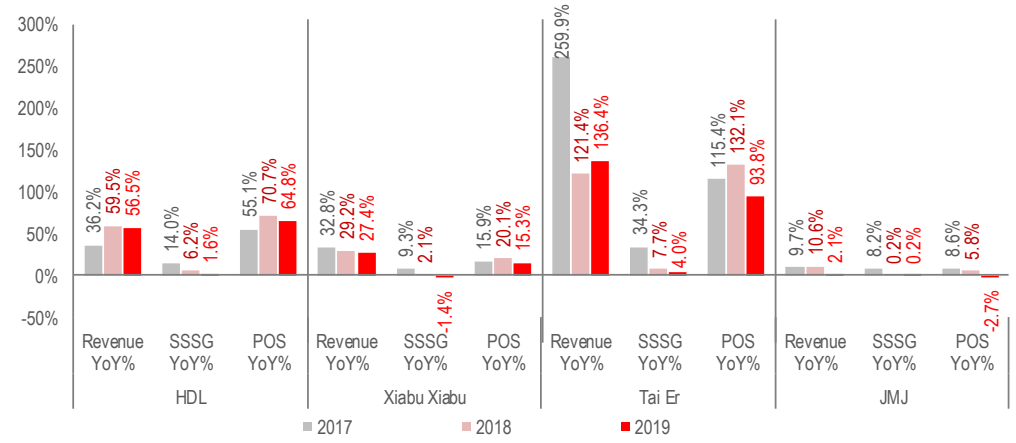


Source: Company data

Revenue drivers

For total revenue, growth is a result of SSSG and store expansion. Figure 34 shows store expansion has been the dominant driver of revenue growth. On that matrix, Haidilao and Tai Er outperform the peer group by a wide margin in terms of expansion driven growth, reflecting their success in solving the scalability problem in China's catering industry.

Figure 34. Revenue growth drivers (2017-19)



Source: Company data

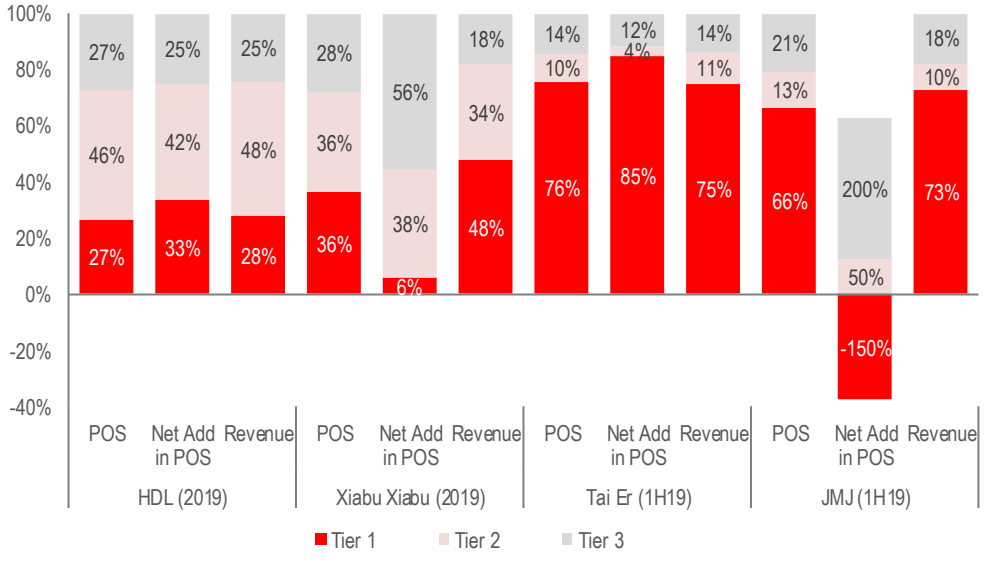
Growth by city tier

Haidilao and Tai Er were still opening more stores in tier 1 cities in 2019, while Xiabu Xiabu started to grow its network more in tier 3 cities

In Figure 35, we compare the current revenue and store network breakdown by city tier as well as change in net store numbers by city tier. We find that Haidilao and Tai Er were still opening more stores in tier 1 cities in 2019, while Xiabu Xiabu started to grow its network more in tier 3 cities. We highlight the following:

- Haidilao: Close to half of its revenue was from tier 2 cities but it opened more stores in tier 1 cities in 2019.
- Xiabu Xiabu: Close to half of its revenue was from tier 1 cities, but more than half of its net openings was in tier 3 cities in 2019.
- Tai Er: Revenue exposure and store expansion were concentrated in tier 1 cities, likely due to its relatively small base in terms of store count.
- JiuMaoJiu: The revenue exposure in tier 1 cities was similar to Tai Er, but the company started to rationalise its store network in tier 1 cities in 2019 by closing down stores on a net basis.

Figure 35. Breakdown of POS, net addition in POS and revenue by city tier

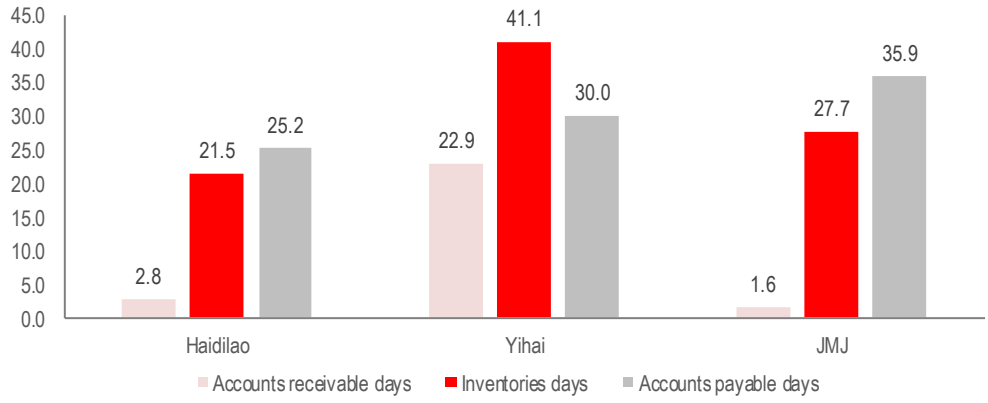


Source: Company data

Working capital cycle

Lastly, we compare the working capital cycle of the peer group.

Figure 36: 2019 WC days comparison



Source: Company data

ESG comparison

- We compare the peer group on ESG matrixes on a like-for-like basis
- This includes board composition and compensation, food safety and nutrients, and environmental and social responsibilities
- We also compare different strategies towards ESG

Board and compensation

In Figure 37, we compare the peer group with regard to board composition and executive compensation. Given the difference in their size, it is no surprise that Yum China's executive compensation was the highest and JMJ's the lowest. On board composition, they all have a similar level of female board representation. JMJ's board is the youngest of the four, while Yum China has the highest independent director ratio.

Figure 37. Board composition and executive compensation (2019)

	Yum China	Haidilao	Yihai	JiuMaoJiu
Independent directors	83%	38%	30%	43%
Percentage of female board members	18%	13%	20%	14%
Average age of directors	56	54	50	42
% of board meetings attended	95%	100%	100%	100%
Board size	11	8	10	7
Board age range	43-70	45-73	40-62	34-50
Total CEO compensation (RMBm)	83.95	36.59	13.14	0.91
Top 5 / 3 highest paid executives average compensation (RMBm)	28.84	16.25	12.96	1.43
Non-executive director average compensation (RMBm)	1.84	2.39	1.92	0.11

Source: Company data, HSBC

Like-for-like ESG comparison

The ESG reports of companies are not easily directly comparable. Here we try to compare the peer group on a like-for-like basis (Figure 38) although the amount of data disclosed varies by company.

Yum China appears to disclose the most ESG data and JMJ the least, likely due to its short listing history.

In terms of energy and water consumption per unit of revenue or per restaurant, the peer group is at comparable levels after considering the differences in restaurant sizes and operating hours.

Figure 38. Like-for-like ESG comparison

		Yum China		Haidilao		Yihai		JMJ
	Unit	2018	2019	2018	2019	2018	2019	2019
FOOD								
Restaurant food safety and quality audits (i.e. operational excellence checks)	times	16,800+	17,000+		2,833		141	Y
Product checks on main menu items	times	4,000+	3,400+		na	Y	Y	Y
Food safety and quality audits on suppliers	times	490+	590+		1,365	Y	Y	Y
ENVIRONMENT								
Average restaurant electricity consumption	MWh	358	342	883	918	na	na	284
Average restaurant energy indirect (Scope 2) GHG emissions	tCO2e	245	233	561	581	na	na	238
Average restaurant water consumption	tons	3,362	3,284	17,074	16,510	na	na	5,784
Package material usage per unit of operating revenue	ton/RMBm	0.9	0.7	0.06	0.09	2.33	3.07	na
Percentage of RSPO-certified palm oil	%	100%	100%	na	na	na	na	na
Percentage of CSR audited critical suppliers	%	100%	100%	100%	100%	100%	100%	100%
Local suppliers as % of total suppliers	%	98.40%	98.70%	100%	100%	100%	100%	100%
Total water consumption	tons	26,395,764	27,602,012	7,956,498	12,679,360	236,681	385,008	1,943,334
Total electricity consumption	MWh	2,814,731	2,870,997	411,480	705,260	52,655	80,756	95,393
Energy indirect (Scope 2) GHG emissions	tCO_2e	1,925,391	1,956,072	261,370	445,871	4.94	5.82	79,815
PEOPLE								
Female share of total workforce	%	61.2%	61.5%	na	na	44%	43%	35.8%
Female share of total management workforce	%	59.0%	54.0%	na	na	na	na	na
Turnover rate of RGMs	%	11.6%	8.2%	na	na	11.8%	30%	51.4%
Training investment per capita	RMB	2,043	~2,000	na	na	na	na	na
Training hour per capita	hours	59	60	na	1.26	10	12	3
Lost-time injury frequency rate (LTIFR) for employees	million hours worked	0.99	1.08	na	na	0.37	0.47	na

Source: Company data, HSBC

ESG strategies

Below, we list each company's strategies towards ESG, especially with regard to food safety, nutrition and health, and public & social welfare.

Figure 39: Yum China ESG summary

	Approach	Progress in 2019
Food safety and quality	Holistic governance and oversight - established a comprehensive and holistic governance system that extends from the Yum China Food Safety Committee of the Board of Directors to functions to oversee the execution of procedures, measures and standards to ensure food safety and compliance	Secure a standardised food safety system at every restaurant - Conducted 17,000+ food safety and quality audits (i.e., operational excellence checks) on restaurants across China - Conducted 3,400+ product checks on main menu items
	A multi-tiered food safety culture – deems food safety an integral part of the corporate culture, and requires employees and suppliers to follow this practice	
	Full value chain reinforcement – food safety and quality management is embedded all the way from upstream suppliers, suppliers, logistics centres, restaurants to delivery. Ensures suppliers and upstream suppliers' compliance with relevant laws and regulations and the company's food safety standards. Ensures supply chain efficiency, promotes food safety and the building of an intelligent supply chain	- Conducted 370+ announced audits and 220+ unannounced audits on suppliers - Conducted sampling tests of 680 key materials provided by 182 suppliers - Logistics centres adopted IoT to monitor real-time product temperature in trucks during transportation
	Emerging industry challenges – closely monitors emerging challenges such as veterinary drugs, pesticides, food additives and GMO. Established animal welfare policies and developed strategies to drive development that benefits all industrial stakeholders	
Nutrition and health	Innovative and diverse offering – through the Innovation Center, works with suppliers to develop nutritious food for customers	- KFC launched the vegetarian burger - About 400 new and updated products were launched by brands
	Nutritional improvement – provides diverse nutritious and healthy food, and advocates a healthy lifestyle and balanced diet	- Purchased more than 52,000 tons of fruit and vegetables, up 8% from 2018 - Improving cooking methods: less salt, less sugar, less oil - A wide variety of ingredients to make well-balanced meals
	Care on Kids' Meal – provides children's meal with less oil and salt, with variety of food including grains, vegetables, fruits, meat-based foods, eggs and milk	-Provided children with balanced meal that is healthy and nutritious
Public awareness and education	Contribution to Healthy China – participates in setting industry standards and supports scientific research and programs on food safety and health	- Contributed to the formulation of 28 food safety-related standards - Chinese Nutrition Society-Yum China Dietary Health Foundation sponsored 7 projects - Hosted 24 sessions of food safety awareness and education, benefiting more than 90,000 people
Animal welfare	Promotes animal welfare in supply chain and in the industry	- Formulated Yum China Animal Welfare Policies
GMO, pesticides, food additives, veterinary drugs and antibiotics	Closely monitors industry challenges, and develops effective response measures to promote development of the industry	- All domestic broiler suppliers abandoned the use of growth-promoting antimicrobials according to China's regulatory requirements

Source: Company data

Figure 40: Haidilao ESG summary

	Approach	Progress (2019)
Food safety and quality	Digital software to monitor restaurants' food safety-technologies enable timely evaluation of food safety risks at restaurants and share the data with the headquarters and restaurants simultaneously, safeguarding the bottom line of food safety	- Introduced Novaq, digital software for monitoring, review and management, to restaurants for on-site inspection on food safety
	Daily management and random inspection of food safety - From daily restaurant management to upstream suppliers, food processing, logistics, and restaurant delivery, Haidilao closely monitors food quality and ensures food safety in the whole value chain	- Conducted 696 on-site samplings of operating restaurants throughout the country and 62 water quality samplings
	Safety management and certification of suppliers - Haidilao has developed a Hazard Analysis and Critical Control Plan (HACCP) to guarantee food safety in procedures from procurement, storage, preparation, packing, and delivery or sale of food	- Conducted a total of 1,365 inspections on 856 suppliers. Reviewed 19 type A suppliers exposed to high risk, with a coverage of 100%
	Ensures safety delivery of food and ingredients, and promotes supply chain efficiency - Self-developed central kitchens and logistics centres create standardised in-house processing, and promotes higher operating efficiency and hygiene practices.	- Added 7 logistics warehouses and 5 central kitchens for fast and convenient processing and delivery in the regions
Nutrition and health	Food innovation through R&D platform to bring optimised and innovative products to customers	- Haidilao Institute (海底撈研究院) allocated cUSD7.5m for R&D and innovation
	Diversified menus to promote innovation through diversified menu items and product development by taking customers' views into consideration	- Haidilao Institute has gained 19 approvals, launched 5 products, applied for 5 patents and protected the independent intellectual property rights of 5 strains of probiotics
Customer services	High quality services with different type of customers – focuses on guest experience and adheres to service-oriented approach, striving to provide a warm and comfortable dining environment	Specific staff assigned to look after children; child-specific meals can be provided in-house
Public awareness and education	Save food concepts - company applies frugal spending logos in restaurants and launches half a portion of food ingredients to reduce the generation of non-hazardous waste	Restaurant non-hazardous waste was reduced during the year
Business integrity	Adheres to the "Three Lines of Defense" mechanism - improved the internal control evaluation mechanism based on the existing one, and developed a compliant and effective internal control framework to improve management efficiency	- Business units set up to conduct a new round of identification and assessment of potential risks facing the operation - Enhanced the business units' early warning capacity and response efficiency towards risks

Source: Company data

Figure 41: Yihai ESG summary

	Approach	Progress (2019)
Food safety and quality	Strict selection criteria for suppliers – suppliers are chosen based on the requirements under the Anti-unfair Competition Law, combined with supplier safety management policy developed by the company	- Adjusted and updated factory-examination standards on raw material suppliers based on different industries
	Spot inspection of suppliers' sites to mitigate raw material risks – on-site spot checks on existing suppliers of raw materials and small hot pot and original equipment manufacturers, intensifying the daily supervision and management of the existing suppliers	- Screened and evaluated all quality management personnel - Conducted work-with-certification training for employees responsible for on-site quality control
	Extensive communication with suppliers – the group regularly organises discussions on standards among suppliers	- Encouraged suppliers to put forward valuable suggestions - Rewarded suppliers for suggestions adopted with cRMB30,000
	Established performance evaluation system on suppliers – continuous on-site visits and evaluation to suppliers to pay close attention to quality control of raw material and auxiliary material	- Provided suppliers (grade A, B, C, and D) with preferential policies, such as financial support, technical coaching - Guided suppliers' management personnel and on-site direction from the group's quality control team - Suppliers rated Grade D twice in a row will be added to the list of eliminated suppliers
Nutrition and health	Complied with national nutrition plan to promote healthy diet – caters for consumers' health demands and committed to providing consumers with healthy food	- Responded to the concept of "Three Reductions and Three Healthiness" proposed in the National Nutrition Plan (2017-30) - Introduced initiatives for salt/oil/sugar reduction, healthy mouth/weight/bones
	Upgrade products by introducing more natural seasoning in pursuit of less additives and more natural seasoning	- Started to identify more natural ways of seasoning and committed to simplifying the ingredient list
Public welfare	Control of COVID-19 – to combat the pandemic and support frontline medical workers, Yihai is committed to supporting the local community	- Donated RMB2m worth of small hot pot products to the Hubei Charity Federation in January 2020 - Donated 40,000 boxes of small hot pot to Jinyintan Hospital in Wuhan and the Renmin Hospital of Wuhan University
	Poverty alleviation – to create education and job opportunities for disadvantaged families/ individuals	- Board of directors organised various departments to participate in diversified social welfare activities with an investment amount of nearly RMB970,000 (RMB490,000 for education and RMB480,000 for charity)

Source: Company data

Figure 42: JiuMaoJiu ESG summary

	Approach	Progress (2019)
Food safety and quality	Strict selection criteria for suppliers - suppliers are chosen based on the requirements of the Anti-unfair Competition Law, combined with the supplier safety management policy developed by the company	- Aiming for no pesticide residue, bio toxin and other hazardous substance policies in the supply of raw materials
	Spot inspection of suppliers' sites to mitigate raw material risks. The group adopts a concentrated procurement policy to guarantee the quality of food ingredients	- Recorded no significant food safety accidents in 2019
	Standardises the supply of raw materials - The group regularly organises discussions about standards requirements among suppliers	
	Internal management policies such as the safety management system which established an inspection and evaluation system among suppliers.	- Rectified potential issues on quality and food safety through stringent access inspection, qualification certification of suppliers
Diversified products for selection	Concentrating on dish R&D - Tracking and evaluating feedback of salespeople and customers on dishes and reviews and updates menus with reference to the results of customer appraisals	- Updated c20-30% of items on its menu each year - Double Eggs (its new brand) updates its menu every 1 1/2 months to improve appeal to customers - Tai Er focuses on core dishes and offers no more than 23 dishes
	Advocates culture of honesty and integrity - conducted anti-corruption training and supplier meetings to elevate the awareness on honesty and integrity	- Conducted a total of 25 training and education activities on integrity for newly-promoted management and newly-appointed functional employees at stores - Enhanced employees' understanding of the corporate culture - Held a meeting with over 150 suppliers to introduce the group's major focus points in 2019 - Specified that the group will consistently optimise the procurement system and called for suppliers to enhance the development of high-quality and standardised products and abide by the integrity agreement
Customer communication	Enhance customer service capabilities and operation control standards - improving customer satisfaction	- Advanced the communication and feedback on customer suggestions and clearly set out guidance and orientation on improving products and services

Source: Company data

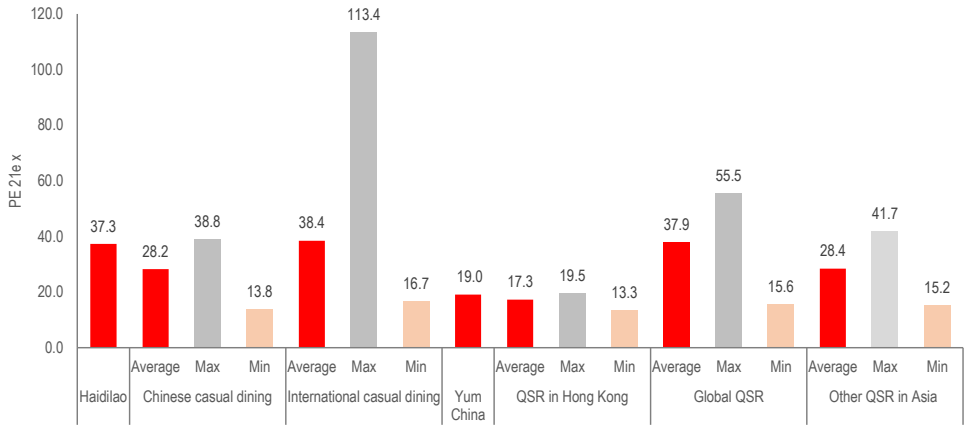
Valuation

- We compare the valuation of companies in the restaurant, condiment and ready-to-eat food segments
- Haidilao trades at the top-end of its peer group by PE, a reflection of how the stock has been rewarded for its superior growth
- Yihai looks more attractive than Chinese condiment peers on a relative basis, given its faster growth profile

Valuation of restaurant companies

In Figure 43, we compare the consensus 2021e PE across Haidilao's peer group. Haidilao's PE is at the high end of the Chinese casual dining peers and in line with the average PE of international casual dining peer group and global QSR peer group.

Figure 43. The peer group PE based on consensus 2021e EPS

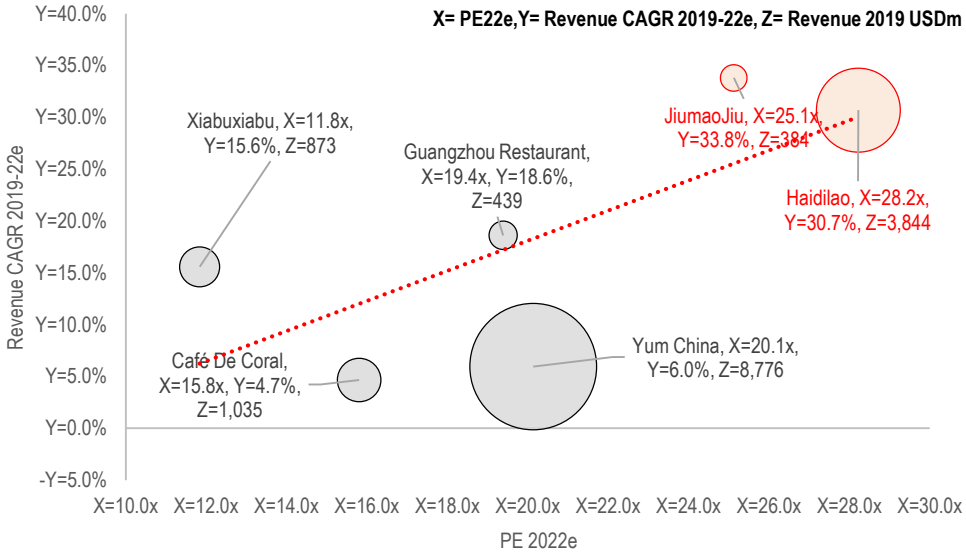


Source: Refinitiv Datastream, HSBC

Then, in Figure 44, we compare the Chinese cuisine restaurant companies based on their growth potential (consensus revenue CAGR over 2019-22e) vs their valuation (consensus PE 2022e) and the size of their revenue (represented by the size of the bubble).

It is clear that Haidilao's current share price reflects its superior growth vs peers. On the other hand, the size of its revenue suggests growth might normalise towards the level of its larger peer, Yum China.

Figure 44. Consensus-based 2022e PE vs revenue CAGR over 2019-22e

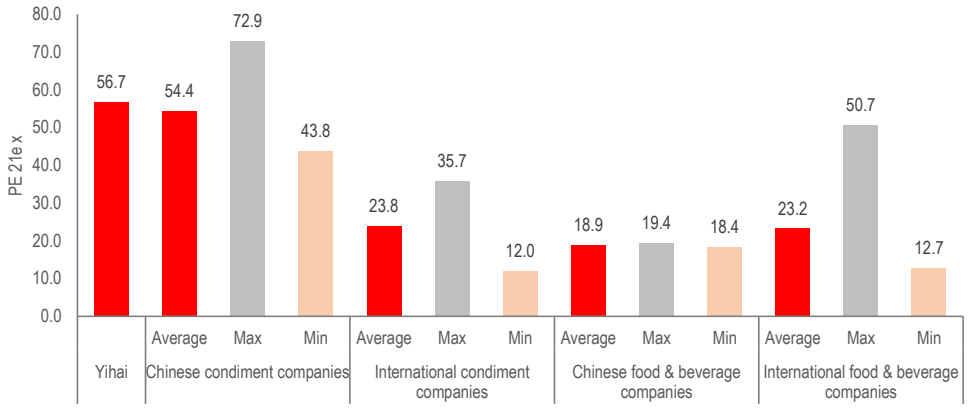


Source: Refinitiv Datastream, HSBC

Valuation of condiment companies

In Figure 45, we compare the consensus based 2021e PE across Yihai's peer group. Yihai's PE is in line with the average of the Chinese condiment peer group and at the high end of the international food & beverage peer group.

Figure 45. The peer group PE based on consensus 2021e EPS

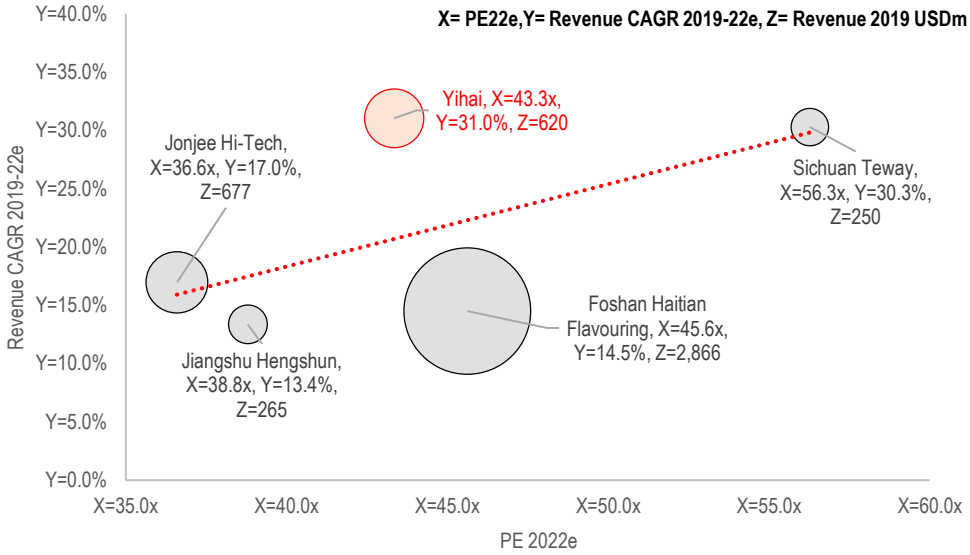


Source: Refinitiv Datastream, HSBC

Then, in Figure 46, we compare the Chinese condiment companies based on their growth potential (consensus revenue CAGR over 2019-22e) vs their valuation (consensus PE 2022e) and their revenue size, which is the size of the bubble.

We think Yihai's valuation is attractive vs the peer group based on its growth profile.

Figure 46. Consensus-based 2022e PE vs revenue CAGR over 2019-22e



Source: Refinitiv Datastream, HSBC

Conclusion

The three companies all trade towards the high end of the peer group. Based on our analysis we draw the following conclusions:

- Haidilao: The market has rewarded the company for its superior growth. However, its revenue size suggests its growth might normalise towards the level of its larger peer, Yum China.
- Jimaojiu: The market has started to appreciate its fast growth. Given a low base with regard to the size of its revenue, the company is likely nowhere near reaching its growth ceiling.
- Yihai: Based on its growth profile, we find valuation is attractive vs the peer Chinese condiment company group.

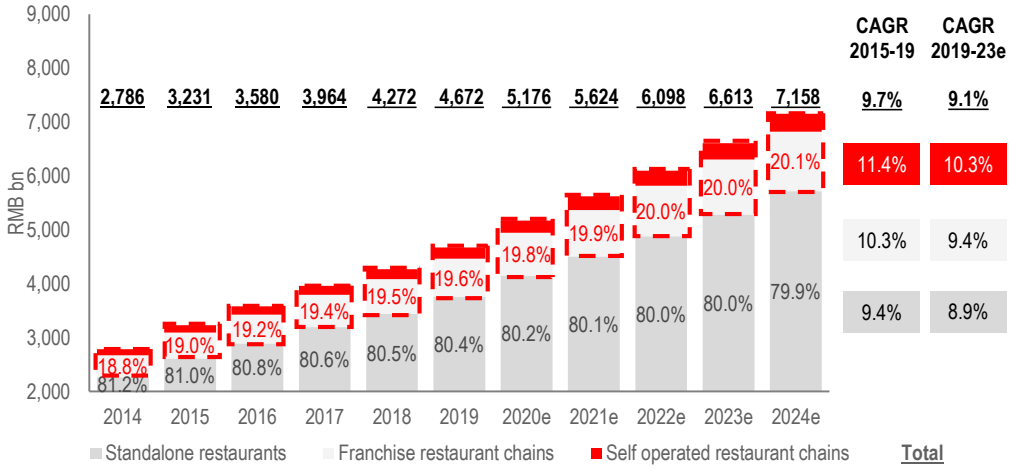
The Chinese cuisine catering industry

- We assess the Chinese cuisine industry in mainland China
- Hot pot and sauerkraut fish are the two fastest growing segments
- The industry is likely to stay highly fragmented; the rare consolidators have the right formula for scaling up their businesses

Industry landscape

According to Frost & Sullivan, 20% of Chinese cuisine revenue in China was generated by chain restaurants in 2019. Of this, self-operated chain restaurants accounted for 4-5% and franchisee chain restaurants 15%. The majority of the restaurants are still individual standalone operations and the pace of consolidation is very slow. Between 2015 and 2019 the market share of chain restaurants grew less than 1ppt to around 20%.

Figure 47. China catering service market revenue (RMBbn)



Source: Frost & Sullivan, National Bureau of Statistics

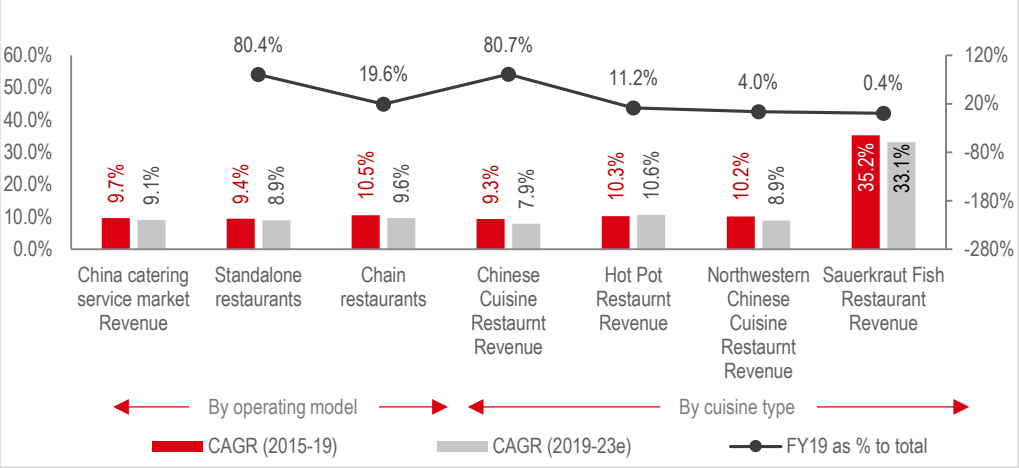
Growth comparison by business model and type of cuisine

In Figure 48, we compare CAGRs over 2015-19 and 2019-23e by business model and type of cuisine (source: Frost & Sullivan). Chain restaurants are expected to grow slightly faster than standalone restaurants.

By cuisine, hot pot and sauerkraut fish are expected outperform, with CAGRs of 10.6% and 33.1% respectively over 2019-23e vs 7.9% for the Chinese cuisine industry.

In term of market size, hot pot accounted for 11% of the total catering industry in China in 2019 and sauerkraut fish only 0.4%. According to iimedia, Sichuan style hot pot accounted for 64.2% of the hot pot market in 2019.

Figure 48. Catering service market growth by operating model and type of cuisine

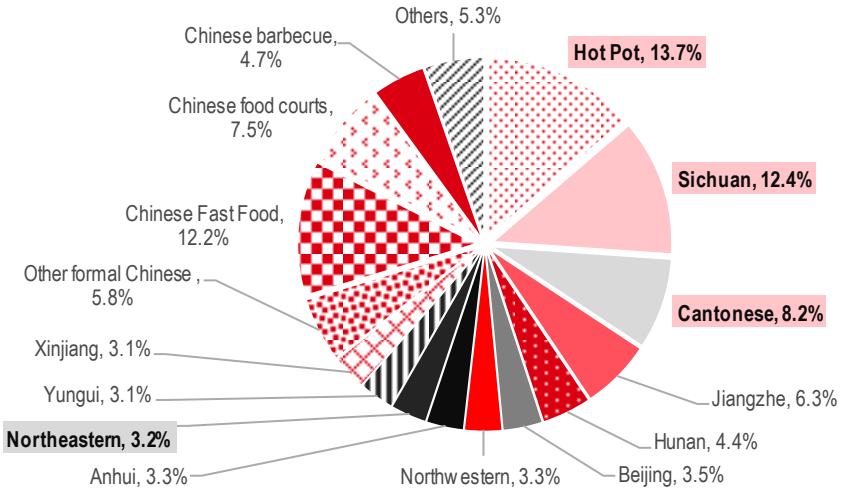


Source: Frost & Sullivan, National Bureau of Statistics

Market breakdown

The Frost & Sullivan data shown in Figure 49 is from 2017 but it reflects the basic structure of the Chinese cuisine market. The three main segments are hot pot (13.7%), Sichuan cuisine (12.4%), and Cantonese cuisine (8.2%). Sauerkraut fish is classified under Sichuan cuisine and accounted for 2% of this sub-segment. We estimate this rose to c4% in 2019.

Figure 49. Breakdown of the Chinese cuisine market (2017)



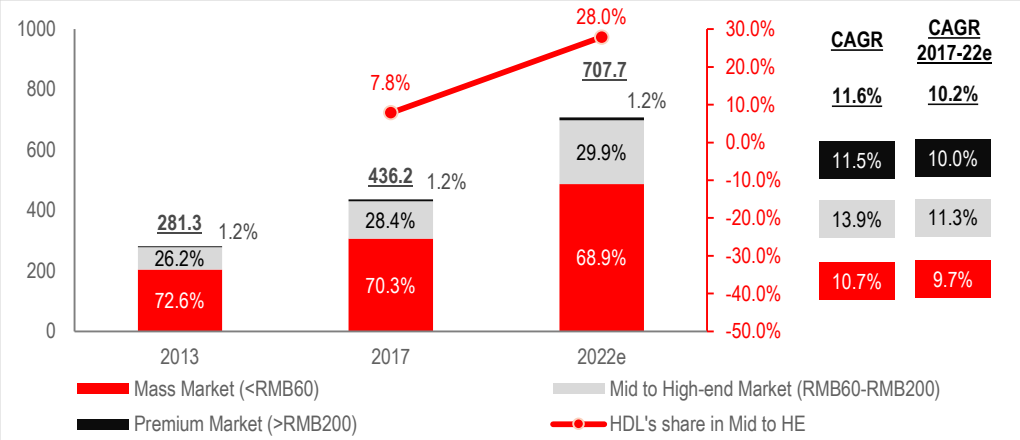
Source: Frost & Sullivan,

The hot pot market – trading-up

Figure 50 shows the breakdown of the hot pot market by average spending per customer (ATK). According to Frost & Sullivan, the mass market (ATK <RMB60) accounted for 7.3% of the segment in 2017, the mid to high-end market 28.4% (ATK RMB60-200) and the premium market (ATK >RMB200) 1.2%.

Haidilao, with after-tax ATK of RMB91, is positioned as mid to high-end hot pot. Frost & Sullivan expects the mid to high-end segment's contribution to the total hot pot market to rise to 29.9% in 2022e. As a reference, Haidilao's share in the mid to high-end segment would then rise to 28% in 2022e from 7.8% in 2017 based on consensus revenue forecast.

Figure 50. Hot pot restaurant market breakdown by average spending per customer



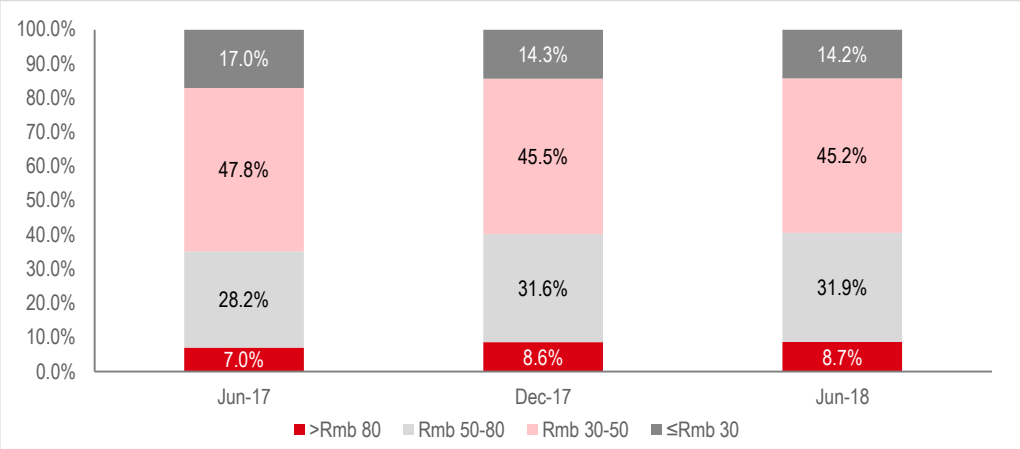
Source: Frost & Sullivan

Haidilao dominates the >RMB80 segment

Figure 51 provides a further breakdown of the mid to high-end hot pot segment (source: Meituan). The below RMB50 segment's contribution of c60% is close to Frost & Sullivan's estimate. The above RMB50 segment is further broken down into ATK >RMB80 and ATK RMB50-80. The ATK >RMB80 accounted for only 8.7% of the market at the end of 2018. We believe this gives more insight about Haidilao's position as it dominates the >RMB80 segment.

Why is this important? We believe there are two implications. First, the trading-up in the hot pot market should directly benefit Haidilao. Second, the company's pricing power is limited to how fast or willing the customers in the mid-to-high end segment are to pay more. This is usually a function of supply and demand as well as the level of consolidation on the supply side.

Figure 51. Per customer spending at hot pot restaurants

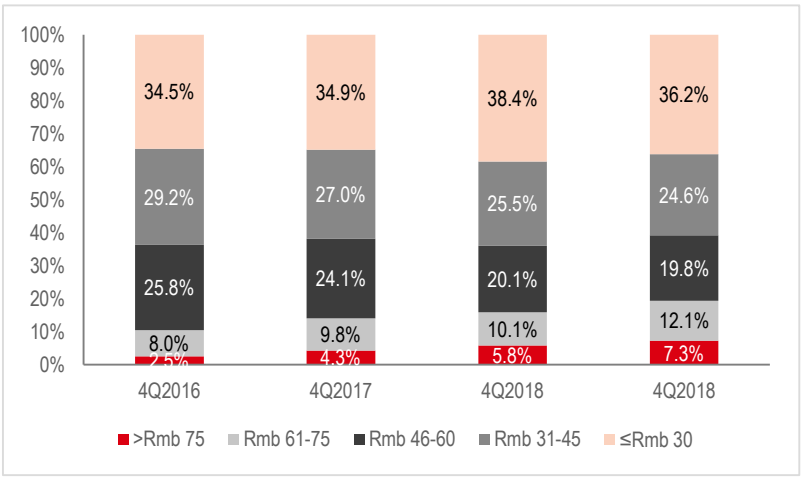


Source: Meituan

Sauerkraut fish – also trading-up

According to Meituan, ATK >RMB75 is the premium segment for sauerkraut fish restaurants. This is where Tai Er is positioned. The trading-up trend from ATK RMB46-60 to above RMB60 was clear in all four quarters in 2018. Similar to Haidilao, this should be positive for Tai Er.

Figure 52. Per customer spending at sauerkraut fish restaurants

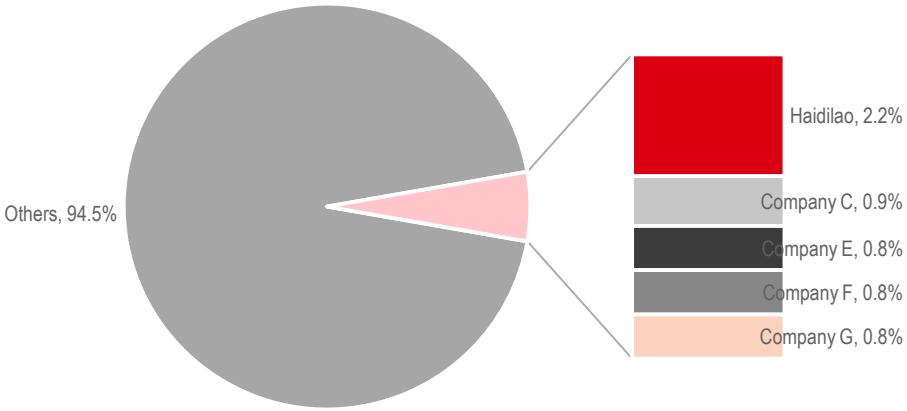


Source: Meituan

Market concentration

Figure 53 shows the top-five hot pot restaurant groups accounted for only 5.5% of the hot pot market in mainland China in 2017; Haidilao's share was 2.2%.

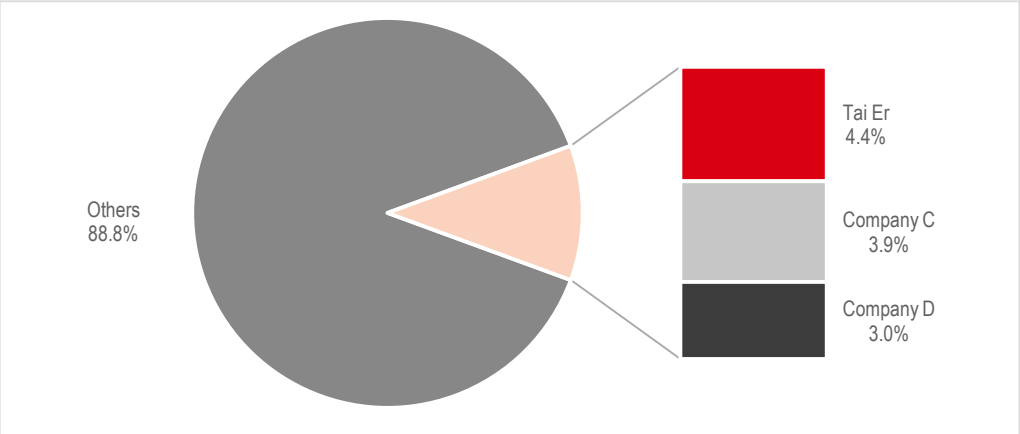
Figure 53. Top-five hot pot restaurants by revenue (mainland China, 2017)



Source: Frost & Sullivan

Figure 54 shows that the top-three sauerkraut fish restaurant groups accounted for only 11.2% of that market in mainland China in 2018; Tai Er's share was 4.4%.

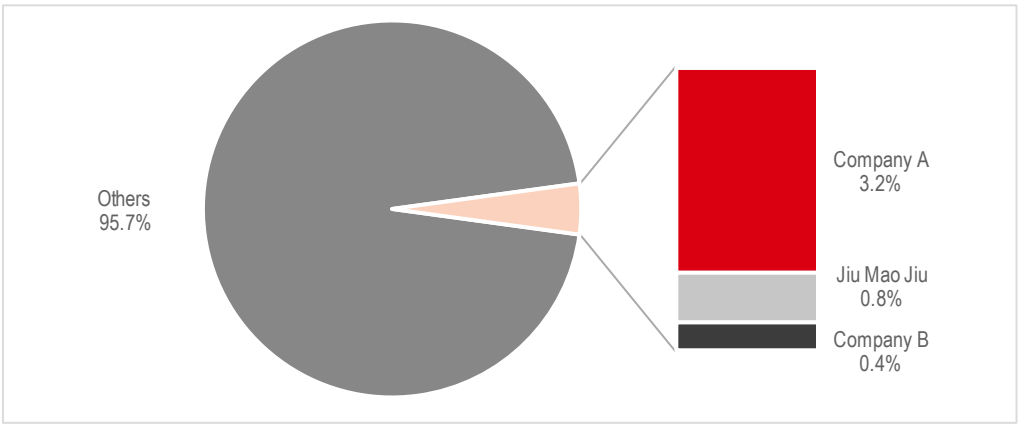
Figure 54. Top-three sauerkraut fish restaurants by revenue (mainland China, 2018)



Source: Frost & Sullivan, National Bureau of Statistics (C, D reflect revenues from both of their self-operated and franchised restaurants

Figure 55 shows the top-three restaurant groups serving north-western cuisine accounted for only 4.3% of the north-western cuisine market in 2018; JiuMaoJiu share under JMJ was only 0.8%.

Figure 55. Top-three north-western Chinese cuisine restaurants by revenue (mainland China, 2018)

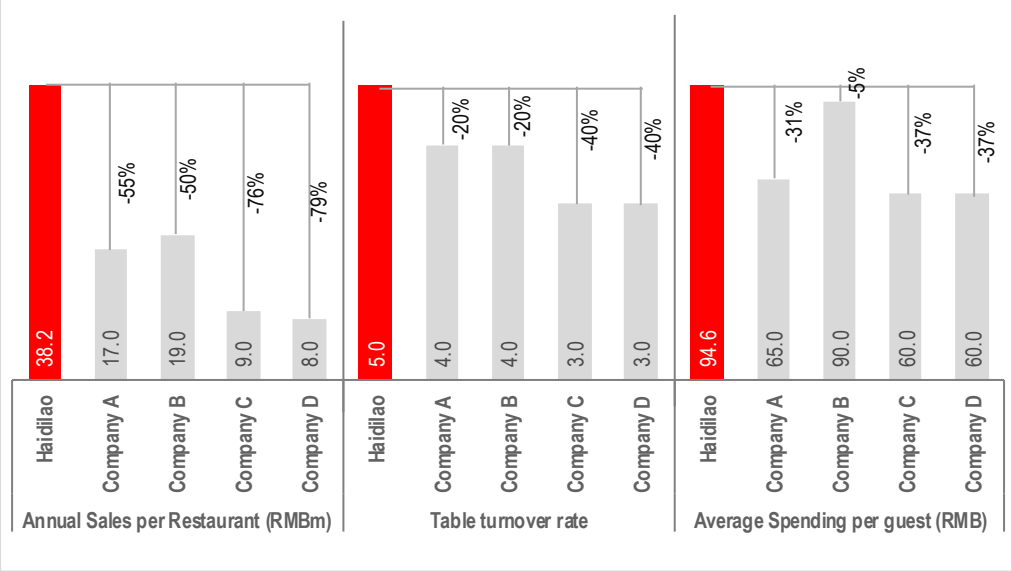


Source: Frost & Sullivan, National Bureau of Statistics

Comparison of sales productivity

Figure 56 compares Haidilao to other restaurants in the top-five group of Chinese cuisine companies by annual sales per restaurant, table turnover and ATK. With respect to Haidilao's outperformance in sales generated per restaurant, roughly half came from its high table turnover and half from higher spending per customer.

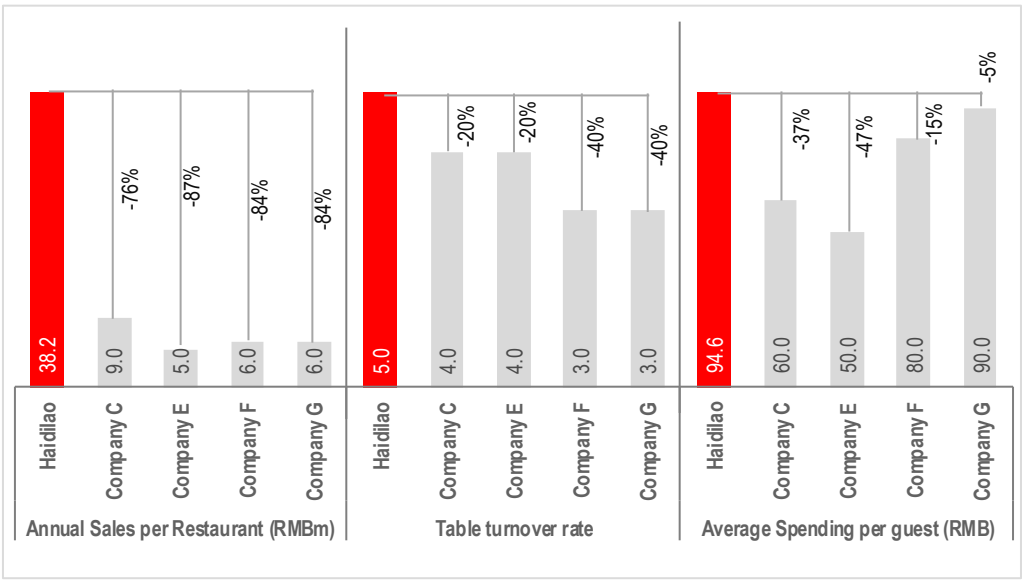
Figure 56 Five largest Chinese cuisine companies in mainland China in terms of gross revenue (2017)



Source: Frost & Sullivan, National Bureau of Statistics

The chart below benchmarks Haidilao to the Top 5 hot pot groups using the same metrics.

Figure 57. Five largest hot pot restaurant groups in mainland China in terms of gross revenue (2017)



Source: Frost & Sullivan, National Bureau of Statistics

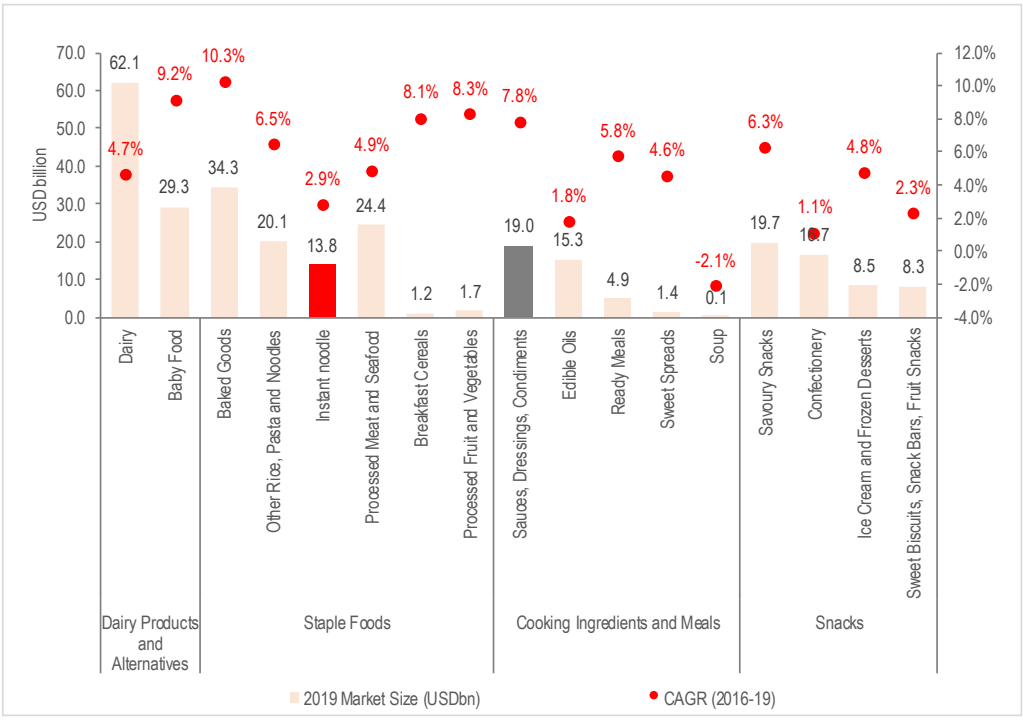
Condiments & instant food

- We look at the condiment and instant food markets, the two biggest drivers for Yihai
- Yihai's condiment market share rose to 22% in 2019, up from 8% in 2015
- In the instant food category, we estimate its market share rose to 2% in 2019, from 0% in 2016

The packaged food market

Condiments and instant food both come under the broader packaged food category. In this chapter we compare them with other packaged food sub-segments in terms of growth rate and market size (Figure 58). The market for condiments, which includes sauces and dressings, totalled USD19.0bn in 2019, which grew at a 2016-19 CAGR of 7.8%. (Note that there is no instant hot pot category in Euromonitor data. The closest category is instant noodles, a USD13.8bn market in 2019, which grew at a 2016-19 CAGR of 2.9%.)

Figure 58. Mainland China's packaged food market and CAGR by category (2016-19)



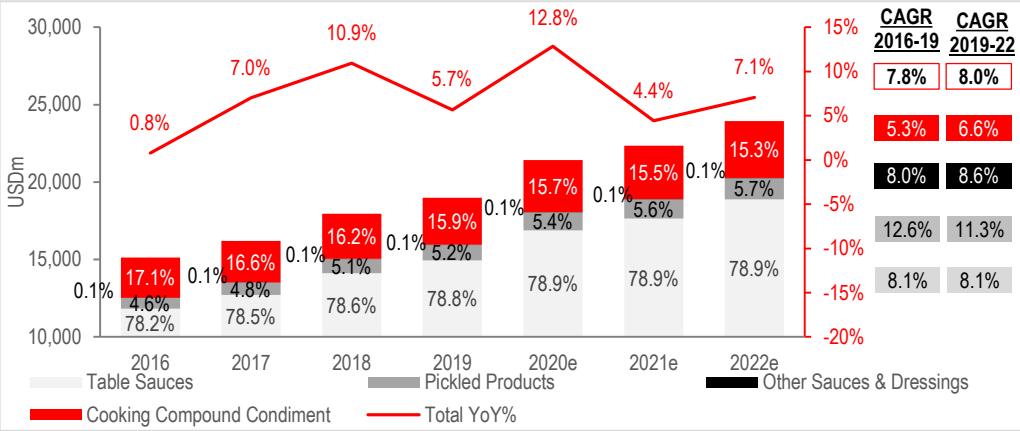
Source: Euromonitor

Condiments and dressings

Market breakdown by category and channel

Figure 59 shows the dressings and condiments industry in mainland China by category. Cooking compound condiments accounted for 15.9% of the market in 2019 and is expected to grow at a CAGR of 6.6% over 2019-22e vs 8.0% for the overall dressings and condiments market.

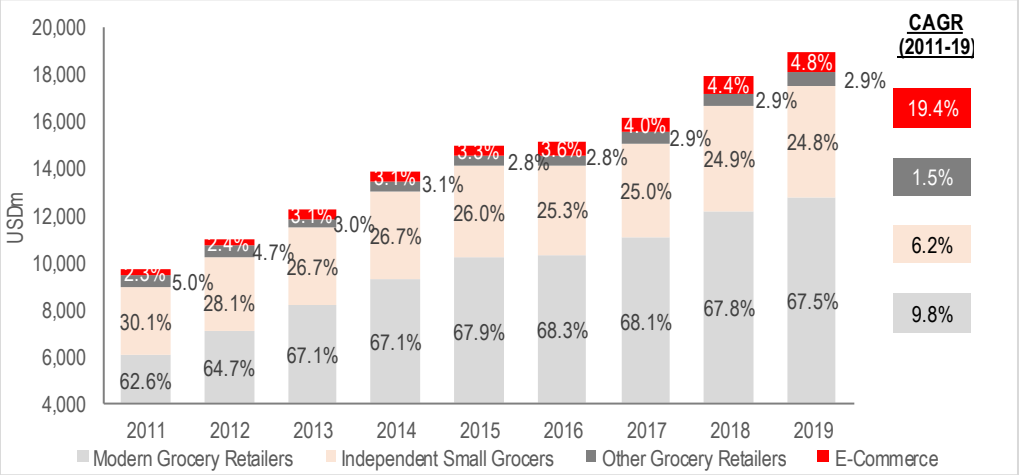
Figure 59. Breakdown of China dressings and condiments industry by category



Source: Euromonitor

By channel, independent small groceries and other grocery retailers accounted for 27% of the retail revenue of the dressings and condiments market in 2019, vs 67.5% for modern grocery retailers (Figure 60). The fastest growing channel is e-commerce, which increased at a CAGR of 19.4% over 2011-19, with its share rising from 2.3% to 4.8%.

Figure 60. Retail channel breakdown of dressings and condiments by value

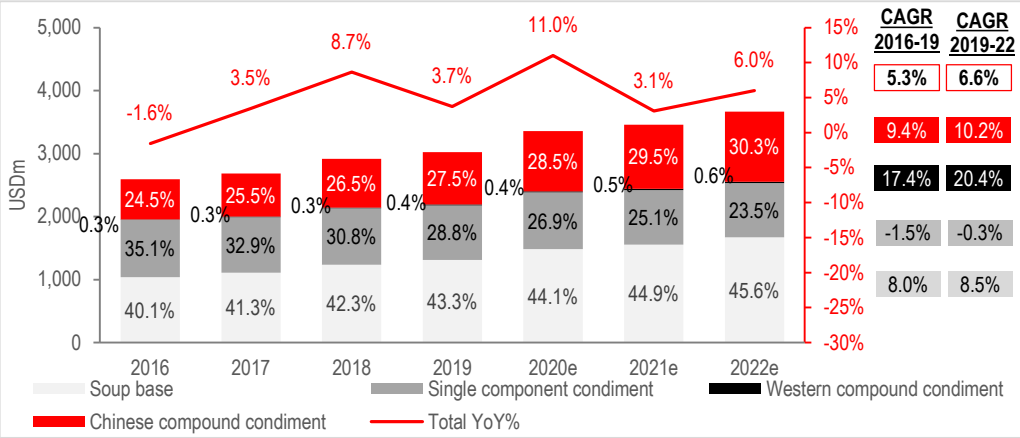


Source: Euromonitor

The cooking compound condiment market

In Figure 61, we provide a further breakdown of the cooking compound condiment segment by product type. Chinese compound condiments accounted for 27.5% of this segment in 2019 and are expected to grow at a CAGR of 10.2% over 2019-22e vs 6.6% for the segment.

Figure 61. Breakdown of the condiment industry by category

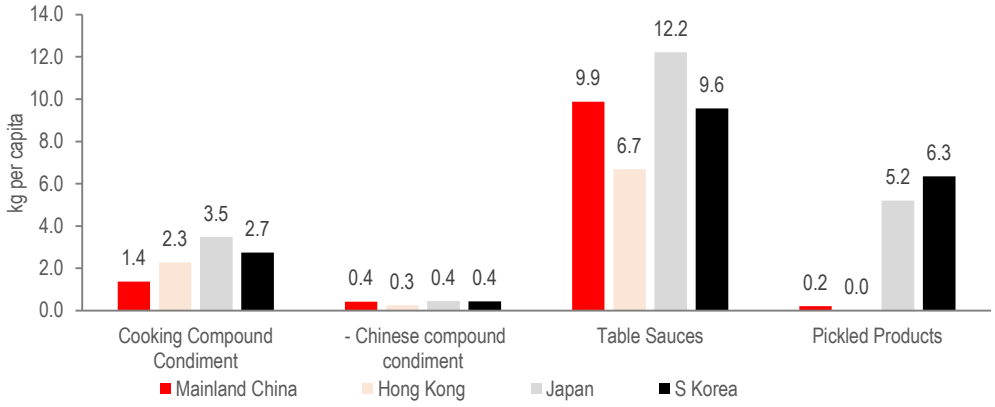


Source: Euromonitor

Per capita consumption

We now compare the per capita condiment consumption in mainland China, with Hong Kong, Japan and South Korea (Figure 62). For most categories it is quite similar across the four markets, which suggests there is room for further growth in mainland China.

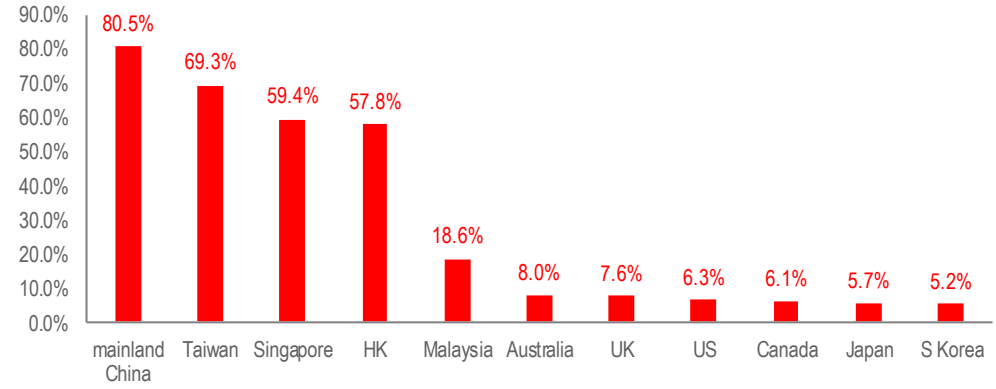
Figure 62. Per capita condiment consumption comparison across markets



Source: Euromonitor

According to Frost & Sullivan, Chinese cuisine accounted for only 5.7% and 5.2% of the catering market in Japan and South Korea in 2017, respectively.

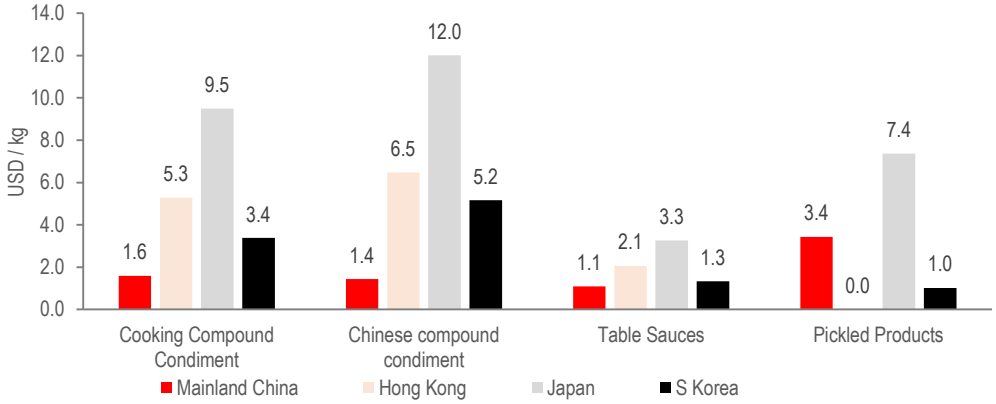
Figure 63. Chinese cuisine market share in major markets (2017)



Source: Frost & Sullivan

Average selling prices (ASPs) in Japan and South Korea are 8-9x and 4-5x higher than in mainland China, suggesting the potential for further trading-up there.

Figure 64. Condiment ASP comparison across markets

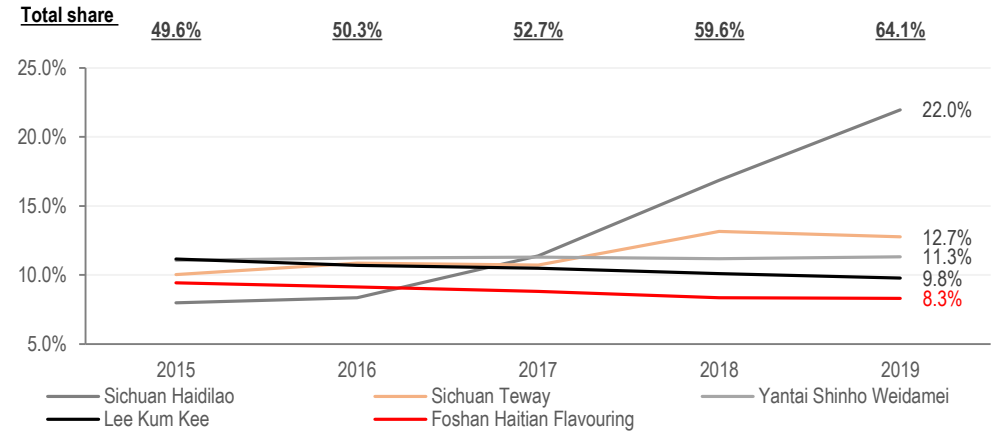


Source: Euromonitor

Market consolidation

Hot pot and Chinese compound condiments together accounted for 75% of Yihai's revenue in 2019, which grew at a CAGR of 41.8% over 2015-19 vs the 7.6% CAGR for the Chinese compound condiment industry (source: Euromonitor). Yihai has seen its market share of the Chinese compound condiment segment rise to 22% in 2019 from 8.0% in 2015.

Figure 65. Mainland China's compound condiment market share



Source: Euromonitor

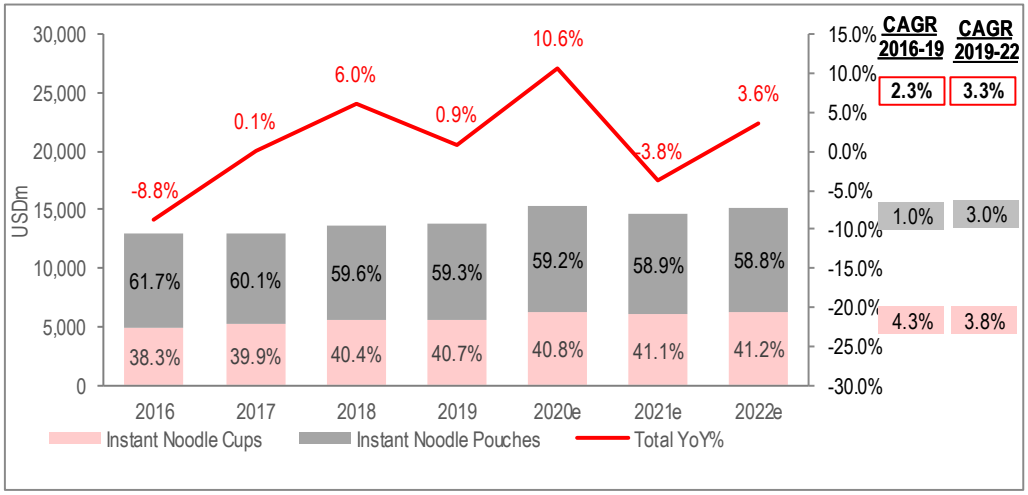
Instant convenient food

Yihai's fast-growing instant convenient food business is led by instant hot pot, which accounted for 23% of the company's revenue last year. Euromonitor does not have a category for instant hot pot. The closest category is instant noodle, which addresses the same consumer need: on-the-go instant food that only requires hot water. The instant noodle segment of China's packaged food industry had a market size of USD13.8bn in 2019.

Market breakdown by category and channel

Figure 66 breaks down the instant industry by category. Instant noodle cups (higher-end) accounted for 41.2% of the market in 2019 and are expected to grow at a CAGR of 3.8% over 2019-22e vs 3.3% for the instant noodle industry. Instant noodle pouches (lower-end) are expected to grow at a slower pace, at 3.0% over 2019-22e, and accounted for 59.3% of segment sales in 2019.

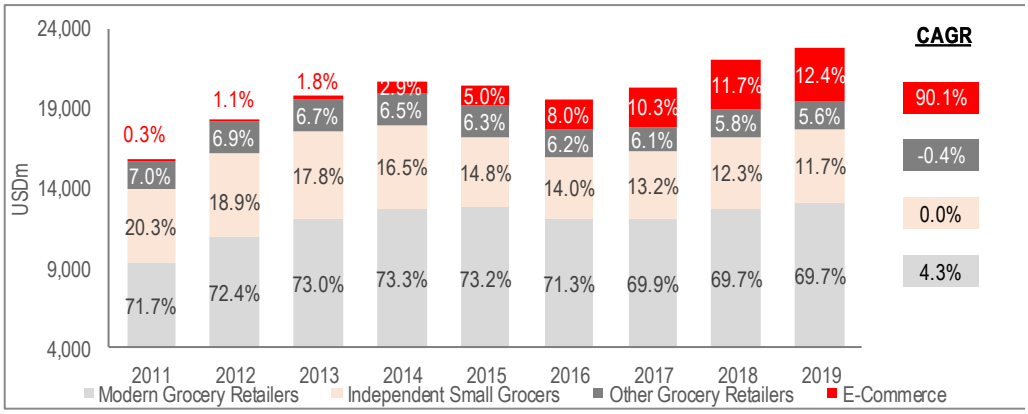
Figure 66. Breakdown of mainland China's instant noodle industry by category



Source: Euromonitor

By channel, independent small grocers accounted for 23.6% of the instant market's retail revenue in 2019 and modern grocery retailers 68.2%. The fastest growing channel is e-commerce – at a CAGR of 90.1% over 2011-19 – reaching a 17.5% channel share last year.

Figure 67. Retail channel breakdown of mainland China's instant noodle market by value



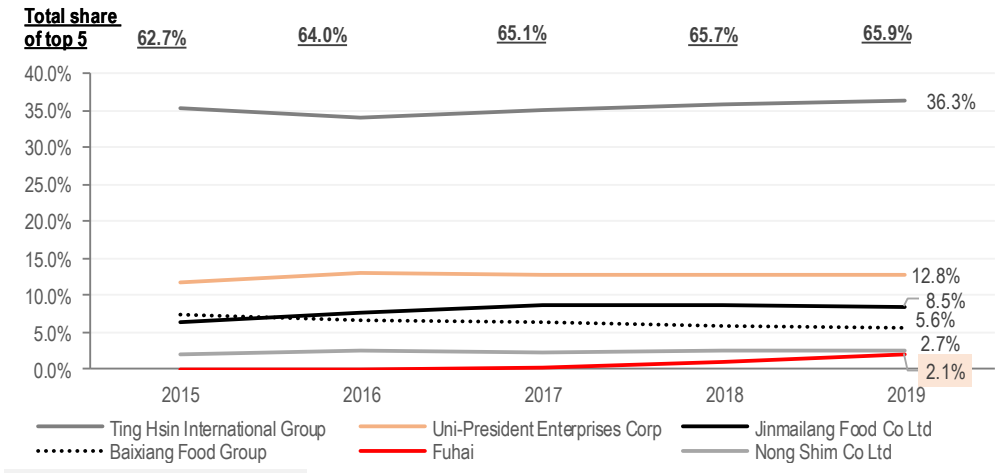
Source: Euromonitor

Market consolidation

Yihai generated revenue of RMB999m from ready-to-eat products (mostly instant hot pot) in 2019. Euromonitor data does not include sales from instant hot pot, which means the data does not cover Fuhai, Yihai's ready-to-eat food subsidiary. Below we show Fuhai's hypothetical market share relative to the instant noodle market, which rose to 2.1% in 2019 from zero before 2017 as a result of the launch of a new instant hot pot product.

Between 2016 and 2019, the value of the instant noodle retail market grew by RMB7.57bn, while Yihai's instant hot pot retail revenue grew to about RMB2bn. This means Yihai accounted for 26% of the growth in the instant noodle market over 2016-19, equal to 0.7ppt a year out of the industry's CAGR of 2.9% over this period.

Figure 68. Instant noodle market share



Source: Euromonitor (*top-five do not include Fuhai)

Haidilao (6862 HK)

- Investors have rewarded Haidilao for its ability to grow rapidly
- But we think the potential deceleration in the pace of its store expansion is likely to impact valuation and margins
- We initiate coverage with a non-consensus Reduce rating and a DCF-based TP of HKD27.40, implying 2021e PE of 31.0x and EV/EBITDA of 15.3x

Company description

Its market cap has increased to USD24.2bn

Haidilao, founded in 1994, was listed on the main board of Hong Kong Stock Exchange in September 2018 at a market cap of USD12.0bn. Its market cap is now USD24.2bn, with annual revenue of USD4.0bn in 2019 (a CAGR of 46.6% over 2015-19). Revenue from restaurant operations accounted for 96.4% of revenue in 2019, and deliveries and sales of condiment products and food ingredients 3.6%.

As of 2019 Haidilao had 768 hot pot restaurants – 716 in mainland China and 52 overseas:

- **Mainland China:** Revenue of RMB24bn in 2019 – 90.3% of the total – at a 2015-19 CAGR of 44.8%.
- **Overseas:** Revenue of RMB2.6bn in 2019 – 9.7% of the total – at a 2015-19 CAGR of 70.2%.

Timeline

Figure 69. Haidilao company milestones

1994	Opened first hot pot restaurant in Jianyang, Sichuan Province
1999	Expanded restaurant network outside Sichuan Province to Xi'an, Shaan'xi Province
2002	Expanded restaurant network to Zhengzhou, Henan Province
2004	Expanded restaurant network to Beijing
2006	Expanded restaurant network to Shanghai
2007	Received the HACCP quality management system certification issued by China Quality Certification
2008	Awarded the title of "Chinese Famous Hot Pot" (中國名火鍋) by the China Cuisine Association
2010	Introduced self-operated hot pot delivery service, being the first restaurant brand in the PRC to introduce such service
2011	"海底撈" (Haidilao) was recognized as a well-known trademark of China by the State Administration for Industry & Commerce (currently known as State Administration for Market Regulation)
2012	Opened first overseas restaurant in Singapore
2013	Opened first restaurant in the United States
2014	Opened first restaurant in South Korea
2014	Opened 100th hot pot restaurant
2015	Opened first restaurants in Japan and Taiwan
2017	Opened first restaurant in Hong Kong
2017	Record annual guest traffic at approximately 106.6 million guests
2018	Opened 300th hot pot restaurant
	IPO on Sep 26 at a price of HKD17.2 and a Market cap of HKD94.4b
2019	Reached revenue of RMB26.6b and 768 restaurants by the end of 2019

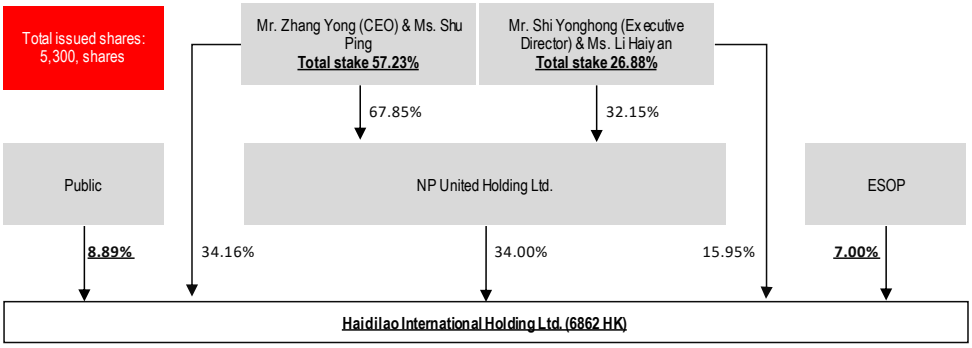
Source: Company data

Board of directors and shareholder structure

Haidilao's board comprises four executive directors, one non-executive director and three independent non-executive directors with a term of three years. Its founder, Mr. Zhang Yong, is CEO and Chairman of the board.

Mr. Zhang and his spouse own 57.23% of the shares and Mr. Shi Yonghong and his spouse 26.88%. Mr. Shi was on the board until 2019.

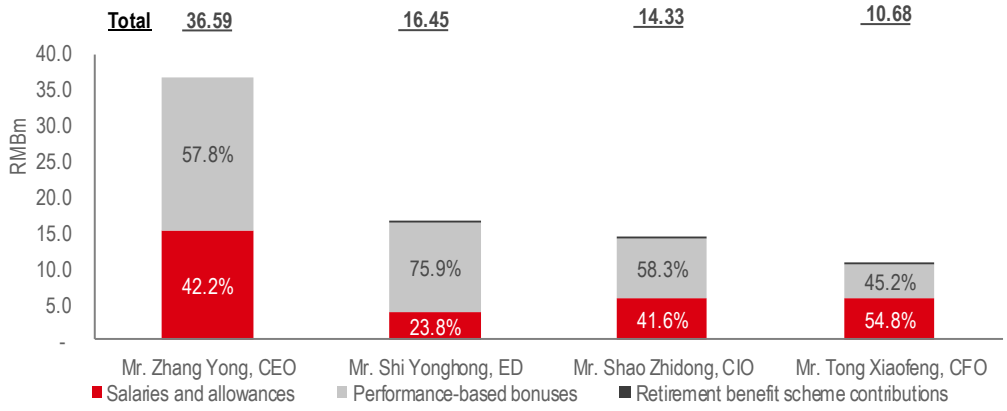
Figure 70. Haidilao shareholding structure



Source: Company data

The figure below shows the total compensation of the company's top executives in 2019.

Figure 71. Haidilao executive compensation



Source: Company data

Investment thesis

Analysing the company's growth expectations. Haidilao has done what few companies in the Chinese cuisine industry have been able to achieve – grow quickly. The number of restaurants rose to 768 in 2019 from 273 in 2017, with a table turnover ratio of 4.8x last year, well above the industry level. How much further can it expand? Our analysis points to a total number of restaurants between 2,027 and 2,714 by 2026e, vs the consensus estimate reaching 1,868 in 2023e.

Deceleration in growth a risk to valuation and margins. We think the deceleration in the pace of store expansion will have negative implications for its current business model, especially in relation to its talent incubation system. We expect the benefits from the incentive scheme to gradually diminish as the pace of expansion slows. Not only do we think that market expectations about the company's growth potential are fully priced in, we also believe there are potential risks to margins as the benefits of the incentive scheme start to fade.

Initiate with a Reduce rating and TP of HKD27.40. We use DCF to derive our TP, based on a WACC of 7.5% and terminal growth rate of 2.0%. The TP implies a 2021e PE of 31.0x and EV/EBITDA of 15.3x. Over 2019-21e, we expect the company to deliver a net profit CAGR of 33.4% on a 34.7% revenue CAGR.

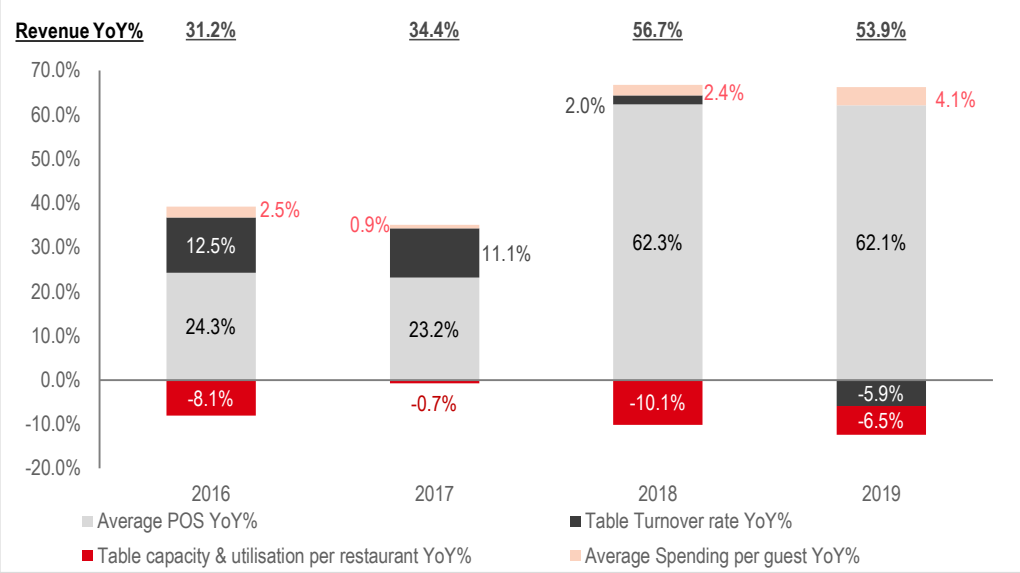
Financial review

Revenue drivers

Figure 72 shows the top-line drivers for Haidilao over 2016-19 – the percentage change in store expansion table turnover y-o-y, average spending per customer (ATK) y-o-y, and y-o-y change in seating capacity.

Most of the growth was driven by restaurant expansion, followed by mid- to low-single digit growth in ATK. Table turnover grew until 2019 when it declined 5.9% y-o-y. Management stated that this was due to a concentration of store openings towards the end of 2019.

Figure 72. Top-line drivers

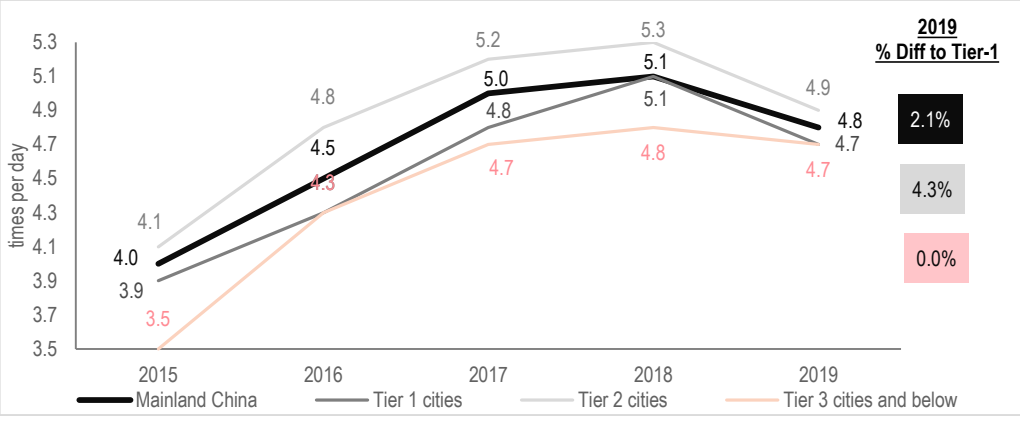


Source: Company data

Historical table turnover and ticket size

Figure 73 shows the table turnover in mainland China by city tier. In 2019, the ratio in tier 2 cities was 4.3% above that of tier 1 cities; for tier 3 and below cities it was in line. The blended table turnover was 2.1% above the level in tier 1 cities. We believe the lower table turnover in tier 1 cities in 2019 was due to the fast growth in store density in these cities.

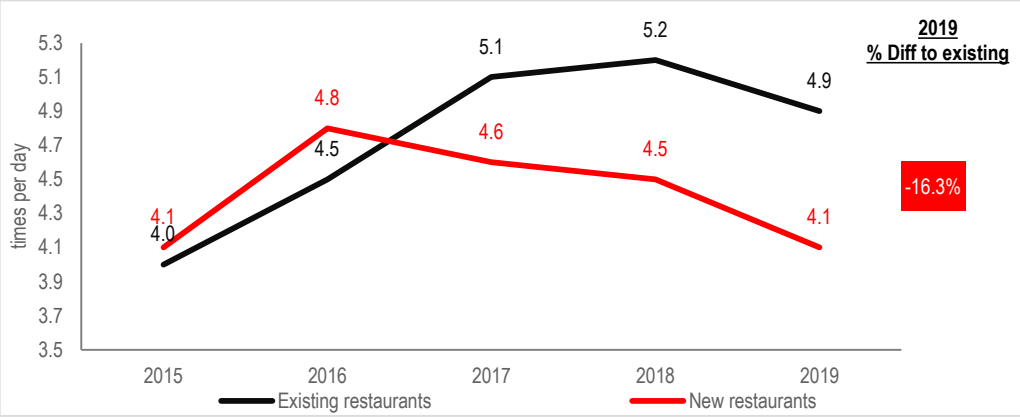
Figure 73. Table turnover by city tier



Source: Company data

Table turnover in new restaurants in 2019 was 16% below that of mature restaurants.

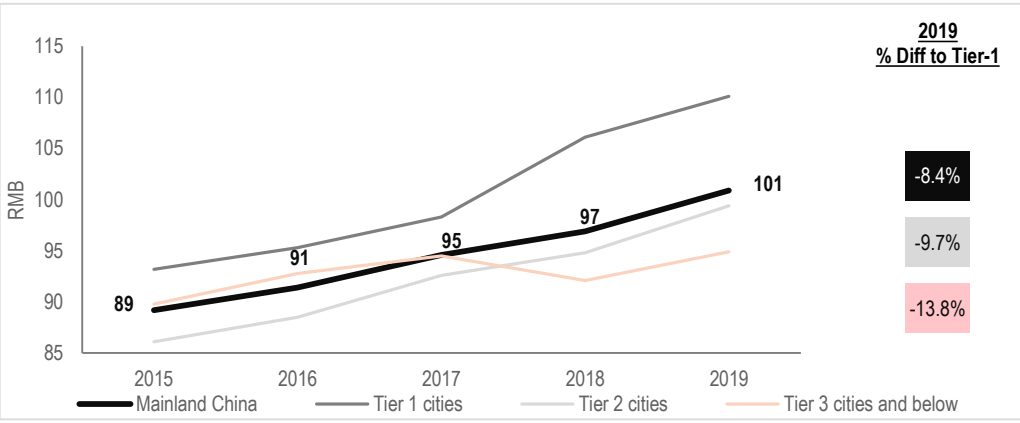
Figure 74. Table turnover by maturity



Source: Company data

In Figure 75, we illustrate the ATK in mainland China and by city tier. In 2019, the ATK in tier 2 cities and tier 3 and below was 9.7% and 13.8% below that in Tier 1 cities, respectively. The blended ATK was 8.4% above that in tier 1 cities.

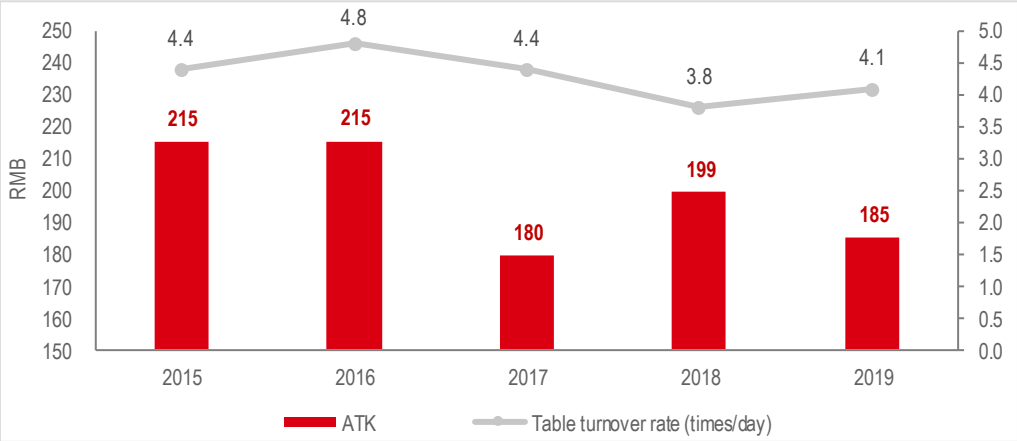
Figure 75. Average spending per customer before tax (RMB)



Source: Company data

For overseas restaurants, ATK and table turnover are shown in Figure 76.

Figure 76. Overseas ATK and table turnover rate

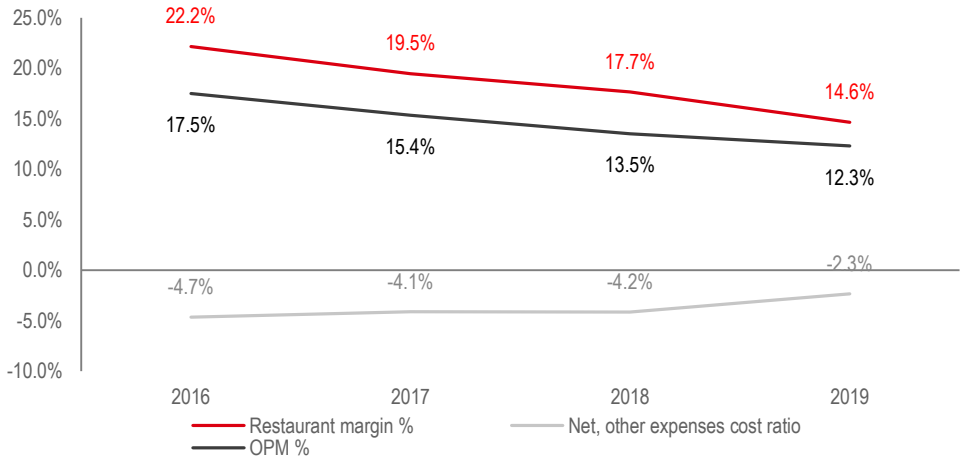


Source: Company data

Historical margins

Figure 77 shows the historical margin trends. They have been adjusted for IFRS 16 by including the cost of amortisation on right-of-use assets, interest cost on lease liabilities and depreciation & amortisation in the costs.

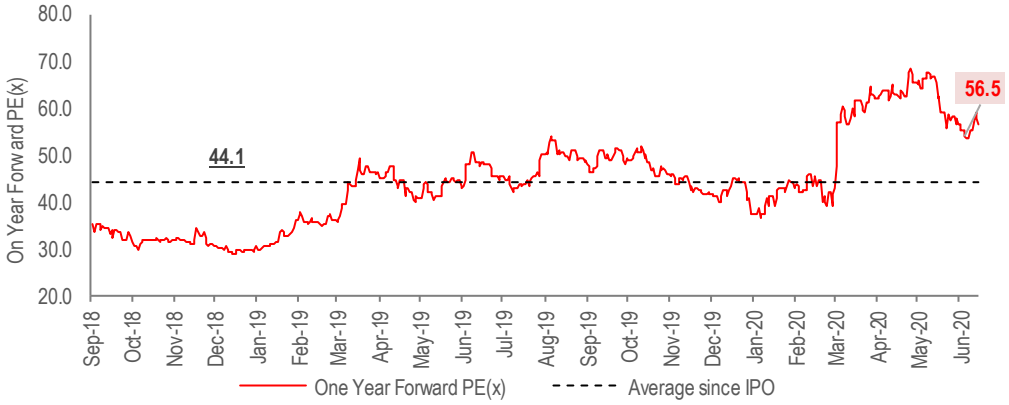
Figure 77. Margin trend, 2016-19



Source: Company data (restaurant margins and OPM adjusted for IFRS 16)

Historical valuation

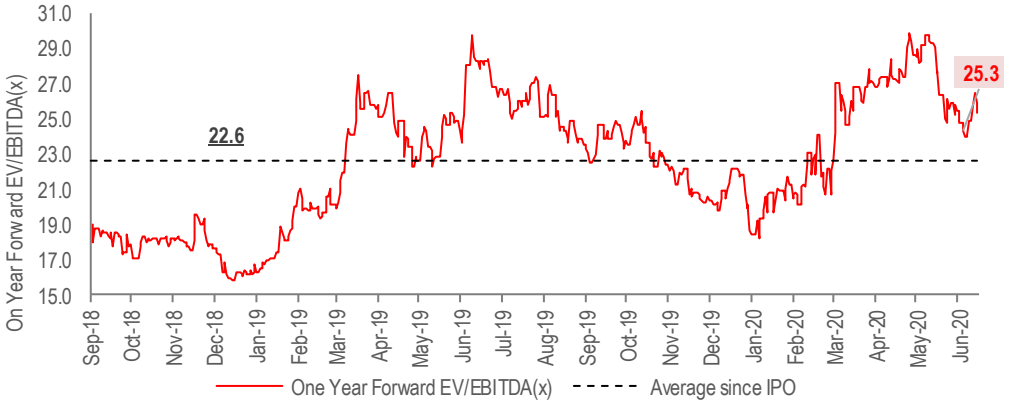
Figure 78. Haidilao one-year forward PE



Source: Bloomberg

Haidilao shares started trading on the Hong Kong Stock Exchange on 26 September 2018. Since then, the stock has traded at an average one-year forward PE of 44.1x, in a range of 28.8-68.3x. The shares now trade at a consensus one-year forward PE of 56.5x.

Figure 79. Haidilao one-year forward EV/EBITDA



Source: Bloomberg

The average EV/EBITDA ratio since the IPO is 22.6x in a range of 15.8-29.9x. The current consensus-based one-year forward EV/EBITDA ratio is 25.3x.

Financial forecasts

Revenue forecasts

In Figure 80, we include the key assumptions used in our revenue forecasts for 2020-22e.

Owing to the impact of COVID-19, we expect revenue to drop 20.0% in 1H20e before recovering to growth of 20.5% in 2H20e. Smoothing out the impact of COVID-19, we expect a revenue CAGR of 34.7% over 2019-21e, leading to a y-o-y rebound of 76.7% in its 2021e revenue.

Figure 80. Revenue drivers

RMBm	2019	1H20e	2H20e	2020e	2021e	2022e	CAGR 2019-21e
Revenue	**26,556**	**9,356**	**17,902**	**27,258**	**48,158**	**60,393**	**34.7%**
yoy %	56.5%	-20.0%	20.5%	2.6%	76.7%	25.4%	
Restaurant revenue	**25,610**	**8,938**	**17,243**	**26,180**	**46,717**	**58,679**	**35.1%**
- China restaurants	23,322	8,055	15,786	23,841	43,292	54,687	36.2%
yoy %	53.7%	-22.4%	21.9%	2.2%	81.6%	26.3%	
Average POS YoY%	67.5%	55.8%	49.4%	49.4%	33.3%	25.9%	
SSSG%	0.7%	-44.7%	-10.0%	-27.3%	32.6%	2.0%	
- Overseas restaurants	2,287	883	1,456	2,339	3,425	3,992	22.4%
yoy %	73.4%	-7.6%	9.4%	2.3%	46.4%	16.5%	
Average POS YoY%	60.0%	58.8%	33.0%	33.0%	22.2%	18.2%	
SSSG%	11.9%	0.0%	0.0%	0.0%	0.0%	0.0%	
Delivery	**449**	**253**	**277**	**530**	**839**	**1,053**	**36.7%**
as % of restaurant revenue	**2%**	**3%**	**2%**	**2%**	**2%**	**2%**	
Others	**498**	**165**	**382**	**547**	**601**	**661**	**9.9%**

Source: Company data, HSBC estimates

Profit forecasts

In Figure 81, we include the key assumptions for our restaurant margin forecasts for 2020-22e. Again, to deliver our IFRS 16 adjusted restaurant margin, we have included the cost of amortisation on right-of-use assets, interest cost on lease liabilities and depreciation & amortisation.

Due to the drop in SSSG in sales and enlarged losses from newly opened restaurants, we expect an IFRS 16 adjusted restaurant margin of -4.4% in 1H20e, before rebounding to 11.9% in 2H20e. For 2H20, we factor in the company paying only minimum wages to restaurant-level employees in February. From March to June, we assume employees earned only their base salary as the drop-off in work volume ruled out higher pay-by-piece salaries being paid.

Going forward, we expect the IFRS 16 adjusted restaurant margin to stabilise at 14.2%. In our forecasts we expect the property rental cost ratio to gradually come down thanks to the leases secured in 2020, which gave the company a much longer rental-free period.

Figure 81. Restaurant margin drivers

	2019	1H20e	2H20e	2020e	2021e	2022e	CAGR 2019-21e
Restaurant profit	**5,924**	**1,053**	**3,925**	**4,978**	**11,234**	**13,493**	**37.7%**
Restaurant margin %	22.7%	11.5%	22.4%	18.6%	23.6%	22.6%	
Restaurant margin adjusted for IFRS 16	14.6%	-4.4%	11.9%	6.3%	14.7%	14.2%	
Raw materials and consumables used	-11,239	-4,190	-7,795	-11,985	-21,152	-26,521	37.2%
As % of restaurant revenue	-42.2%	-44.7%	-43.4%	-43.8%	-43.8%	-43.8%	
Staff costs	-7,993	-3,299	-5,165	-8,464	-13,291	-17,356	29.0%
As % of restaurant revenue	-30.7%	-35.9%	-29.5%	-31.7%	-27.9%	-29.1%	
Property rentals	-1,095	-674	-938	-1,612	-2,154	-2,591	40.3%
As % of restaurant revenue	-4.2%	-7.3%	-5.4%	-6.0%	-4.5%	-4.3%	
Utilities expenses	-912	-640	-653	-1,293	-1,709	-2,101	36.9%
As % of restaurant revenue	-3.5%	-7.0%	-3.7%	-4.8%	-3.6%	-3.5%	
D&A	-1,253	-874	-1,071	-1,945	-2,558	-3,039	42.9%
As % of restaurant revenue	-4.8%	-9.5%	-6.1%	-7.3%	-5.4%	-5.1%	

Source: Company data, HSBC estimates (*including amortisation on right-of-use assets, interest cost on lease liabilities)

In Figure 82, we show our forecasts for other net profit drivers.

- A RMB404m loss from the restaurant business in 1H20e, an operating loss of RMB845m and an OP loss ratio of 9.0%.
- In 2He, we expect OPM to normalise to 9.7% and then stabilise in 2021e and 2022e at 11.9% and 11.7% respectively vs 12.3% in 2019.
- Over 2019-21e, we expect net profit and operating profit to grow at CAGRs of 33.4% and 32.5%, respectively, on a revenue CAGR of 34.7%.

Figure 82. Net profit drivers

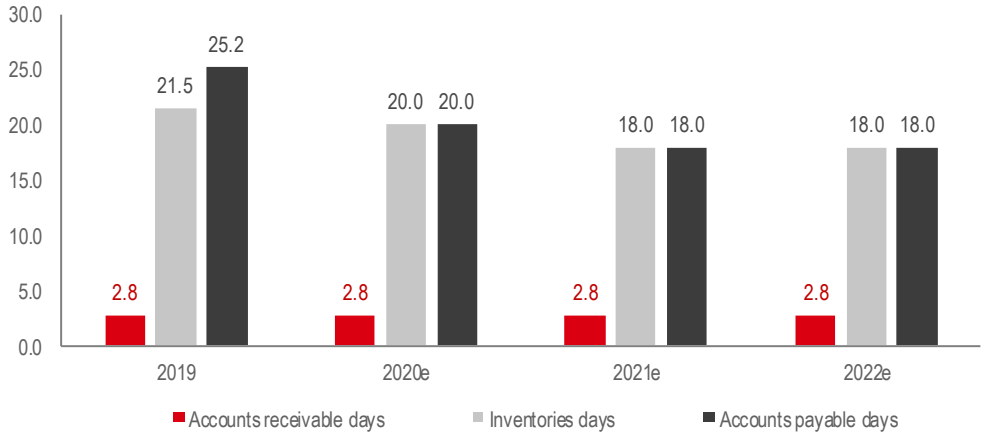
RMBm	2019	1H20e	2H20e	2020e	2021e	2022e	CAGR 2019-21e
IFRS 16 adjusted Restaurant Profit	**3,816**	**(404)**	**2,089**	**1,685**	**6,993**	**8,456**	**35.4%**
GP from other revenue	249	82	191	274	301	331	9.9%
Other Income	263	135	135	270	228	304	
Travelling and related expenses	-220	-30	-100	-130	-182	-182	
Listing expenses	0	0	0	0	0	0	
Other expenses	-1,000	-577	-643	-1,220	-1,693	-2,003	
Share of profit of an associate	75	59	69	128	128	166	
Share of loss of a joint venture (51% in Ying Hai Holdings)	-10	-30	-5	-35	-35	-35	
Other gains and losses	95	-80	0	-80	0	0	
Adjusted operating profit, incl interest on operating leases	**3,268**	**-845**	**1,736**	**892**	**5,739**	**7,037**	**32.5%**
Yoy %	42.5%	-167.0%	-13.5%	-72.7%	543.7%	22.6%	
OP margin	12.3%	-9.0%	9.7%	3.3%	11.9%	11.7%	
EBITDA	**4,521**	**29**	**2,807**	**2,837**	**8,297**	**10,076**	**35.5%**
Yoy %	51.6%	-98.4%	3.3%	-37.3%	192.5%	21.4%	
EBITDA margin	17.0%	0.3%	15.7%	10.4%	17.2%	16.7%	
Interest on bank or other borrowings	-20	-10	-10	-20	-20	-20	
Effective tax rate	27.7%	0.0%	17.7%	35.0%	27.0%	26.5%	
Minority payout	0.1%	0.1%	0.2%	0.1%	0.1%	0.1%	
Net profit	**2,345**	**-857**	**1,419**	**564**	**4,171**	**5,152**	**33.4%**
Yoy %	42.4%	-194.1%	-1.0%	-75.9%	639.4%	23.5%	
Net margin	8.8%	-9.2%	7.9%	2.1%	8.7%	8.5%	

Source: Company data, HSBC estimates

Working capital forecasts

We expect inventory to largely be financed by trade payables in our forecast period.

Figure 83. Working capital forecast (days)



Source: Company data, HSBC estimates

Balance sheet and cash flow forecasts

Based on our forecast of a 35.0% dividend pay-out ratio, we expect the company to remain in a net cash position. The capex for opening a new store is RMB10m.

Figure 84. Cash flow summary

RMBm	2019	2020e	2021e	2022e
Operating cash flow	**4,580**	**3,351**	**7,888**	**9,649**
- EBITDA	4,521	2,837	8,297	10,076
Capex	**-4,944**	**-4,500**	**-4,500**	**-4,500**
Dividends	703	141	1,251	1,546
- Dividend payout ratio	27.7%	35.0%	27.0%	26.5%
Net cash	**3,796**	**2,507**	**4,643**	**8,246**
Gross gearing	2.2%	2.0%	1.5%	1.2%

Source: Company data, HSBC estimates

1H20 profit warning

Haidilao published profit warning announcements on the Hong Kong Stock Exchange on 6-7 July 2020. It expects to record c20% y-o-y decrease in 1H20 revenue, and to record a net loss ranging from RMB900m to approximately RMB1bn in 1H20.

Our estimate for 1H20e revenue is a 20% decline and a net loss of RMB857m.

HSBC estimates vs consensus

Our net profit estimate for FY20e is 63% below consensus and that for 2021e and 2022e are 1.8% and 6.2% below consensus, respectively.

Figure 85. HSBC vs consensus

	2020e			2021e			2022e		
RMBm	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff
Net revenue	27,258	30,146	-9.6%	48,158	48,659	-1.0%	60,393	60,566	-0.3%
Operating profit	1,187	2,540	-53.3%	6,107	5,986	2.0%	7,490	7,554	-0.9%
Net profit	564	1,536	-63.3%	4,171	4,245	-1.8%	5,152	5,492	-6.2%

Source: Refinitiv Datastream, HSBC estimates

Valuation and risks

Figure 86. WACC calculation

WACC calculation	
Cost of equity	7.5%
Cost of debt	3.0%
Tax rate	25.0%
Target equity ratio	100.0%
Target debt ratio	0.0%
Risk free rate (Rf)	2.5%
Equity risk premium	5.0%
Beta	1.00
WACC	**7.5%**

Source: HSBC estimates

We initiate coverage on Haidilao with a DCF-based target price of HKD27.40. This gives us 25.8% downside from the current share price and, as such, we initiate with a Reduce rating.

The weighted average cost of capital (WACC) in our DCF model is 7.5% and is based on a risk-free rate of 2.5%, a market risk premium of 5.0% for China-H shares, and a company-specific

beta of 1.0. The cost of debt is 3% and the company has a 0:100 debt-to-equity ratio. We assume a 2.0% terminal growth rate.

We build our DCF valuation model until 2022e based on our financial estimates, and semi-explicit estimates up to 2028e by using simplified assumptions such as: 1) EBIT margin staying flat at 12.0% in 2023-28e vs 11.7% in 2022e; 2) sales growing at a 12.7% CAGR in 2021-28e vs a 34.7% CAGR in 2019-21e; 3) capex intensity as indicated by capex as a percentage of sales declining to 3.1% in 2028e from 9.3% in 2021e; and 4) the tax rate staying flat at 26.5% in the forecast period.

We use the HSBC FX team's end-2020e RMB-HKD exchange rate of 1.12. Our target price of HKD27.40 implies a 2021e PE of 31.0x and a 2022e PE of 25.1x vs an average of 43.9x since the IPO.

Figure 87. DCF valuation summary

	RMBm
+ PV 2019-28e year cash flow	31,959
+ PV terminal value	94,719
= Enterprise value	**126,678**
+ Net cash	2,507
= Equity value	**129,185**
Shares issued (m)	5,300
Value per share (RMB)	24.37
HKD: RMB FX rate	1.122
Value per share (HKD)	**27.40**

Source: HSBC estimates

Potential share price catalyst: 1H20 results.

Key company-specific upside risks:

- Shortening of the breakeven period of new restaurants thanks to faster-than-expected growth in demand
- Lower-than-expected lease costs thanks to the favourable contracts secured amid COVID-19
- Much better-than-expected economics for restaurants opened overseas
- Successful acquisitions to utilise cash on the balance sheet
- Raising the dividend pay-out to shareholders

Financials & valuation: Haidilao International

Reduce

Financial statements

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Profit & loss summary (CNYm)				
Revenue	26,556	27,258	48,158	60,393
EBITDA	4,521	2,837	8,297	10,076
Depreciation & amortisation	-1,253	-1,945	-2,558	-3,039
Operating profit/EBIT	3,268	892	5,739	7,037
Net interest	-237	-316	-388	-473
PBT	3,247	871	5,719	7,017
HSBC PBT	3,247	871	5,719	7,017
Taxation	-900	-305	-1,544	-1,859
Net profit	2,345	564	4,171	5,152
HSBC net profit	2,345	564	4,171	5,152
Cash flow summary (CNYm)				
Cash flow from operations	4,580	3,351	7,888	9,649
Capex	-4,874	-4,500	-4,500	-4,500
Cash flow from investment	-5,026	-4,500	-4,500	-4,500
Dividends	-689	-689	-689	-689
Change in net debt	1,608	1,290	-2,136	-3,603
FCF equity	-294	-1,149	3,388	5,149
Balance sheet summary (CNYm)				
Intangible fixed assets	204	184	164	144
Tangible fixed assets	12,621	16,095	18,759	20,778
Current assets	7,200	5,922	8,819	13,006
Cash & others	2,222	932	3,068	6,671
Total assets	20,614	22,789	28,330	34,517
Operating liabilities	9,766	10,858	12,757	14,541
Gross debt	122	122	122	122
Net debt	-2,100	-810	-2,946	-6,549
Shareholders' funds	10,623	11,704	15,342	19,739
Invested capital	8,038	10,411	11,916	12,715

Ratio, growth and per share analysis

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Y-o-y % change				
Revenue	56.5	2.6	76.7	25.4
EBITDA	51.6	-37.3	192.5	21.4
Operating profit	42.5	-72.7	543.7	22.6
PBT	43.6	-73.2	556.4	22.7
HSBC EPS	34.1	-75.9	639.4	23.5
Ratios (%)				
Revenue/IC (x)	4.8	3.0	4.3	4.9
ROIC	43.1	6.4	37.7	42.1
ROE	24.4	5.1	30.8	29.4
ROA	15.5	3.6	17.4	17.5
EBITDA margin	17.0	10.4	17.2	16.7
Operating profit margin	12.3	3.3	11.9	11.7
EBITDA/net interest (x)	19.1	9.0	21.4	21.3
Net debt/equity	-19.8	-6.9	-19.2	-33.2
Net debt/EBITDA (x)	-0.5	-0.3	-0.4	-0.6
CF from operations/net debt				
Per share data (CNY)				
EPS Rep (diluted)	0.44	0.11	0.79	0.97
HSBC EPS (diluted)	0.44	0.11	0.79	0.97
DPS	0.13	0.13	0.13	0.13
Book value	2.00	2.21	2.89	3.72

Key forecast drivers

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Net addition in the restaurants	302	293	303	313
China SSSG %	1	-27	33	2
Restaurant Margin %	23	19	24	23
Effective Tax Rate %	28	35	27	27

Valuation data

Year to	12/2019a	12/2020e	12/2021e	12/2022e
EV/sales	6.3	6.2	3.4	2.7
EV/EBITDA	36.8	59.2	20.0	16.1
EV/IC	20.7	16.1	13.9	12.7
PE*	72.2	300.0	40.6	32.8
PB	15.9	14.5	11.0	8.6
FCF yield (%)	-0.2	-0.7	2.0	3.0
Dividend yield (%)	0.4	0.4	0.4	0.4

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2019a
GHG emission intensity*	138.7
Energy intensity*	290.5
CO_2 reduction policy	Yes
Social Indicators	**12/2019a**
Employee costs as % of revenues	30.1
Employee turnover (%)	n/a
Diversity policy	Yes

Governance Indicators	12/2019a
No. of board members	8
Average board tenure (years)	2.8
Female board members (%)	12.5
Board members independence (%)	37.5

Source: Company data, HSBC

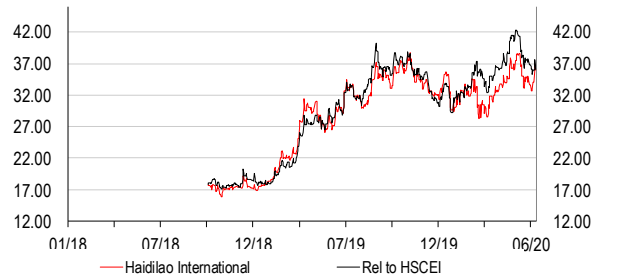
* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (HKD)	35.35
Target price (HKD)	27.40
RIC (Equity)	6862.HK
Bloomberg (Equity)	6862 HK
Market cap (USDm)	24,175

Free float	100%
Sector	Hotels Restaurants & Leisure
Country/Region	China
Analyst	Lina Yan
Contact	+852 2822 4344

Price relative



Source: HSBC

Note: Priced at close of 09 Jul 2020

JiuMaoJiu (9922 HK)

- We expect its fast fashion casual dining brand, Tai Er, to deliver a revenue CAGR of 63% over 2019-21e
- Tai Er also generates a much higher restaurant margin than the mature JMJ brand, leading to a 65% net profit CAGR over 2019-21e
- We initiate coverage with a Buy rating and a DCF-based target price of HKD16.90, implying 41.3x 2021e PE and 15.3x 2021e EV/EBITDA

Company description

Jiumaojiu, founded in 2005, was listed on the main board of the Hong Kong Stock Exchange in January 2020 at a market cap of USD1.8bn. Its annual revenue was USD390m in 2019.

The company operates 336 restaurants under five different brands

At the end of 2019, the company operated 336 restaurants under five different brands – JiuMaoJiu, Tai Er, Double Eggs, Cooking Spicy Kebab and Uncle Chef. Of these, 292 are self-operated and 44 franchised. JiuMaoJiu (143) and Tai Er (126) have the largest number of restaurants.

- **JiuMaoJiu:** Revenue of RMB1.4bn in 2019 – 51% of the total – at a 2017-19 CAGR of 6.8%. The reported operating margin was 17.7% in 2019.
- **Tai Er:** Revenue of RMB1.3bn in 2019 – 48% of the total – at a 2017-19 CAGR of 128.8%. The reported operating margin was 21.5% in 2019.
- **Others:** Revenue of RMB0.04bn in 2019 – 1% of the total. Reported operating margin was -33.0% in 2019.

Timeline

Figure 88. JiuMaoJiu company milestones

1995
First noodle restaurant opened in Haikou
2005
Branded as "Jiumaojiu"
2010
Upgraded business strategy. Changed to fast fashion chained catering style. Focused on opening new restaurants in shopping malls
2012
Established Beijing and Shenzhen branches
2013
Established Tianjin branch
2014
Established Wuhan branch
2015
Opened the 99th restaurant
2015
Opened first Tai Er restaurant
2017
Awarded "2017 China catering 100 strongest brand"
2017
Opened first Double Eggs restaurant
2018
Awarded "2018 China catering 100 strongest brand"
2019
Opened first "Cooking Spicy Kebab" and "Uncle Chef" restaurants
15 Jan 2020
Listed on the Hong Kong Stock Exchange with IPO price of HKD6.6 and market cap of HKD9.8bn

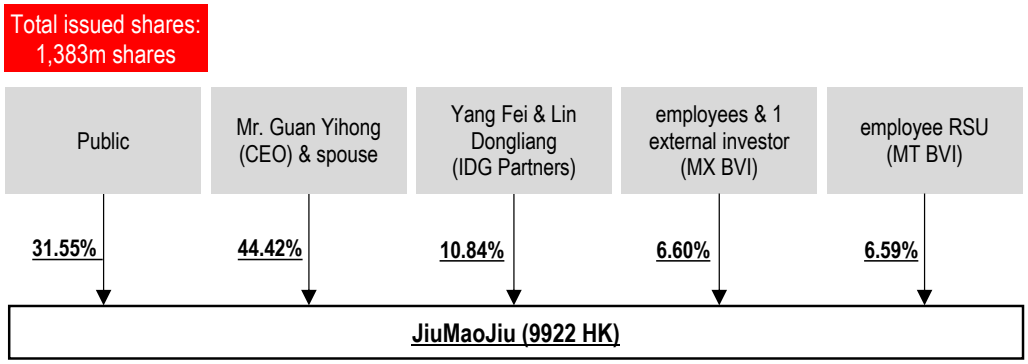
Source: Company data

Board of directors and shareholder structure

Jiumaojiu's board comprises three executive directors, one non-executive director and three independent non-executive directors with a term of three years. Mr. Guan Yihong is the Chairman and CEO.

Mr. Guan and his spouse own 44.42% of the shares. Former employees, current employees and one third-party investor hold a 6.6% stake in the company through MX BVI from a pre-IPO investment. A venture capitalist holds 10.84% of the shares. The restricted share program is held under MT BVI and has a 6.59% interest in the company.

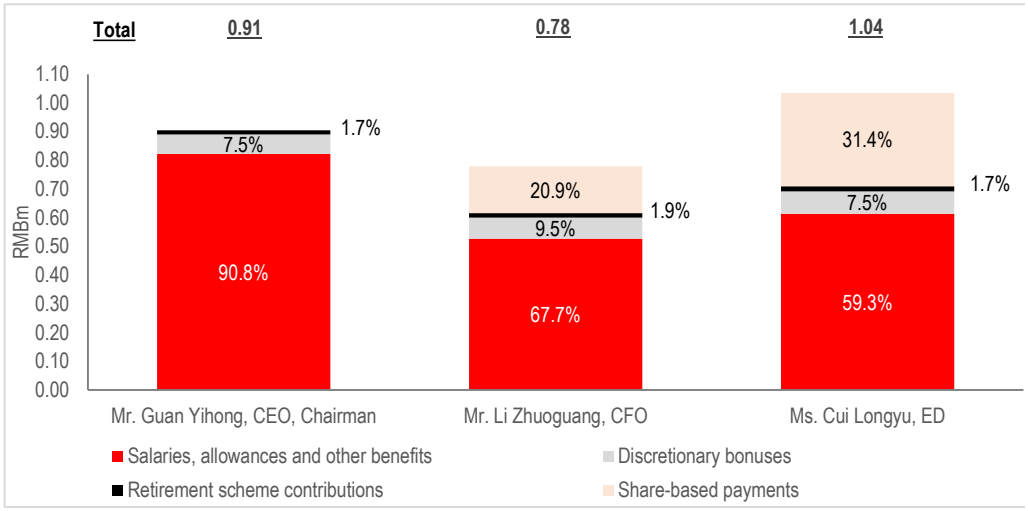
Figure 89. JiuMaoJiu shareholding structure



Source: Company data

The figure below shows the total compensation of the top executives in 2019.

Figure 90. JiuMaoJiu executive compensation



Source: Company data

Investment thesis

Tai Er is on the fast track. Revenue in 2019 was split equally between two brands – JiuMaoJiu (northwestern Chinese cuisine) and Tai Er (Chinese spicy fish, known as sauerkraut fish) – but Tai Er is the main revenue and profit driver. The first Tai Er restaurant opened in 2015 and the new brand delivered a revenue CAGR of 166% over 2016-19. In 2019, with 126 restaurants, it accounted for 47% of the group's revenue. As discussed in "Two pathways to scalability", we believe the Tai Er brand has found its own formula to further scale up and it can maintain strong momentum from a low base, supported by the capital raised from the IPO.

Improve the JMJ brand. JMJ seems to have stagnated. It grew at a CAGR of only 6.8% in 2017-19 and we expect this to drop to 3% over 2019-21e due to rationalisation of the restaurant chain. However, now that management has established a successful business model for Tai Er, it has room to rejuvenate the JMJ brand. For example, the minimalist model used for Tai Er is being introduced to JMJ. The number of SKUs has been halved and the size of new restaurants was reduced in 2019. Should the initiative be successful, it could become a new growth engine

for the company. In 2019, JMJ accounted for 51% of group revenue and 54.4% of total restaurant profits.

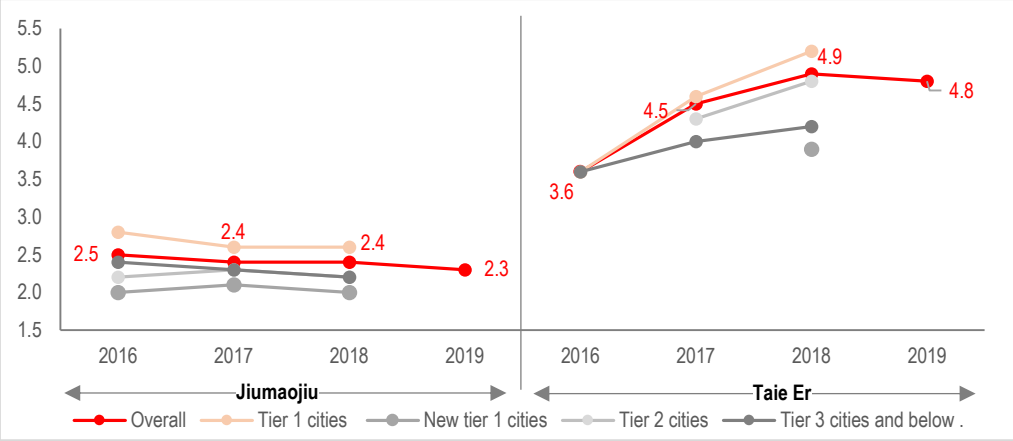
Initiate with a Buy rating and a TP of HKD16.90. We use a DCF model to derive our TP, based on a WACC of 9.5% and terminal growth rate of 2.0%. The TP implies a 2021e PE of 41.3x and EV/EBITDA of 15.3x. Over 2019-21e, we expect the company to deliver a net profit CAGR of 65.2% on a 33.1% revenue CAGR.

Financial review

Historical table turnover and ticket size

In Figures 91-92, we show the historical top-line drivers for Jiumaojiu over 2016-19 – y-o-y changes in table turnover and average spending per customer (ATK). In 2019, the table turnover for Tai Er was 4.8x and JMJ's 2.3x.

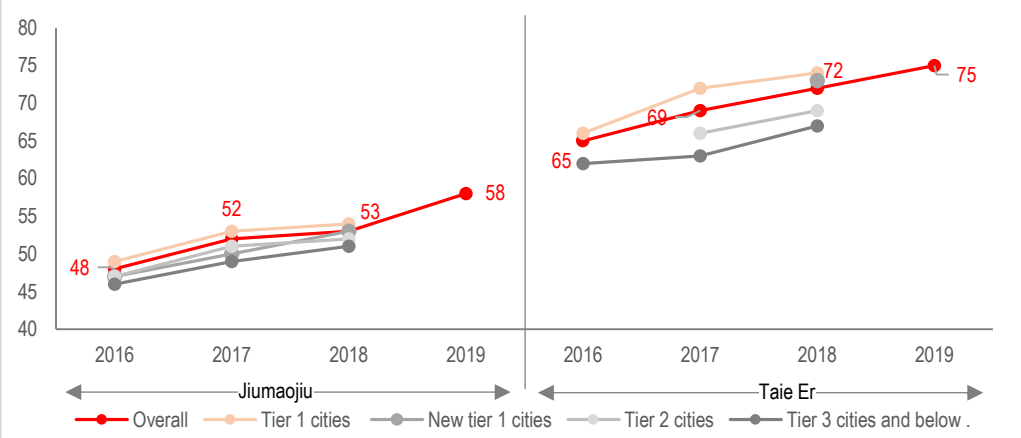
Figure 91. Table turnover by city tier



Source: Company data

In 2019 the ATK for Tai Er was RMB75 vs RMB58 for JMJ.

Figure 92. Average spending per customer after tax, by city tier (RMB)

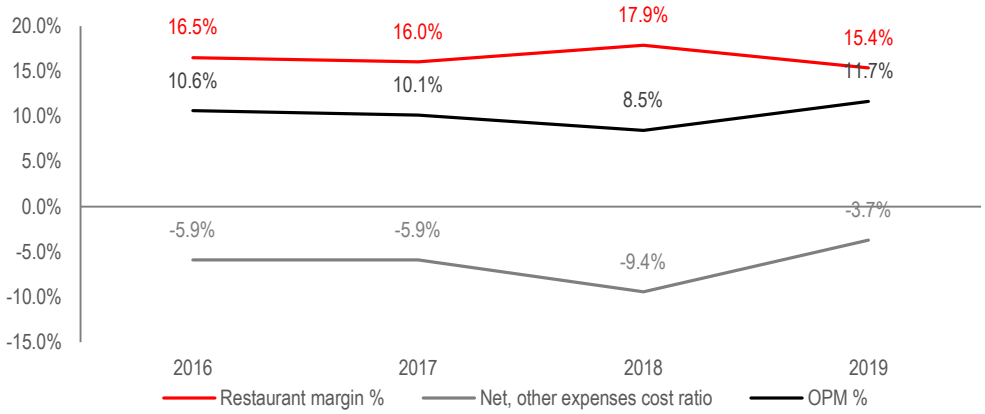


Source: Company data

Historical margins

Figure 93 shows historical margin trends. They have been adjusted for IFRS 16 by including the cost of amortisation on right-of-use assets, interest cost on lease liabilities and depreciation & amortisation.

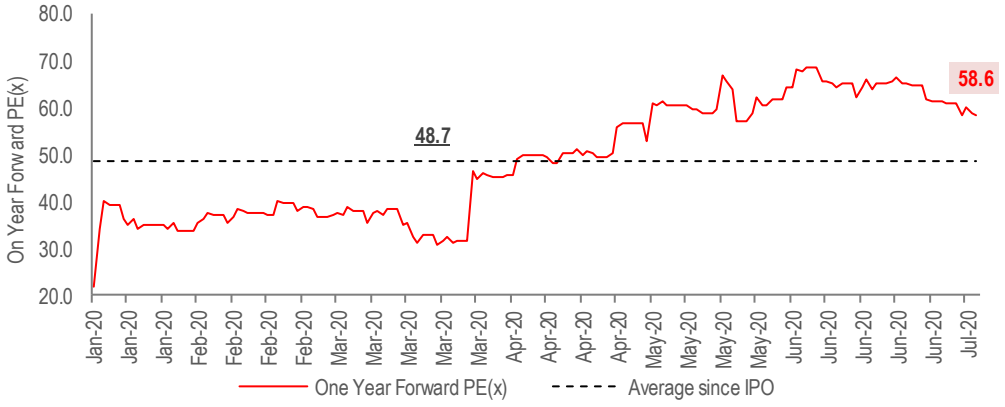
Figure 93. Margin trend, 2016-19



Source: Company data (Restaurant margins and OPM adjusted for IFRS 16)

Historical valuation

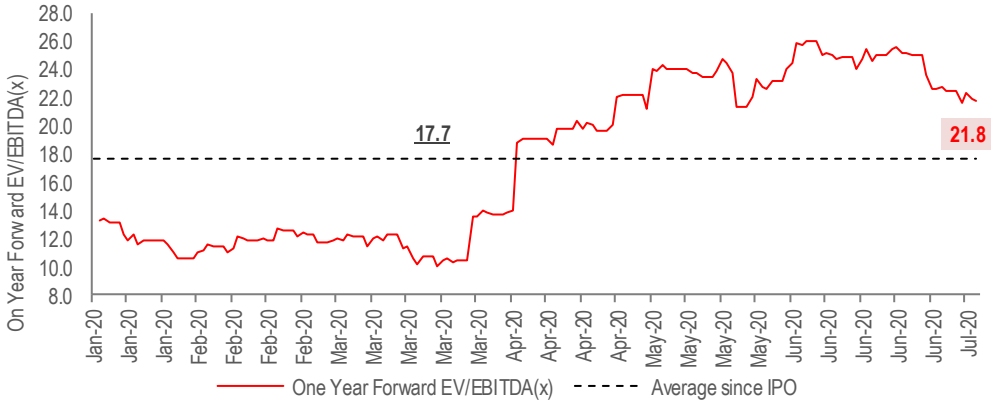
Figure 94. JiuMaoJiu one-year forward PE



Source: Bloomberg

Jiumaojiu shares started trading on the Hong Kong Stock Exchange on 15 January 2020. Since then, the stock has traded at an average one-year forward PE of 48.7x, in a range of 22.0-68.5x. The shares now trade at a consensus one-year forward PE of 58.6x.

Figure 95. JiuMaoJiu one-year forward EV/EBITDA



Source: Bloomberg

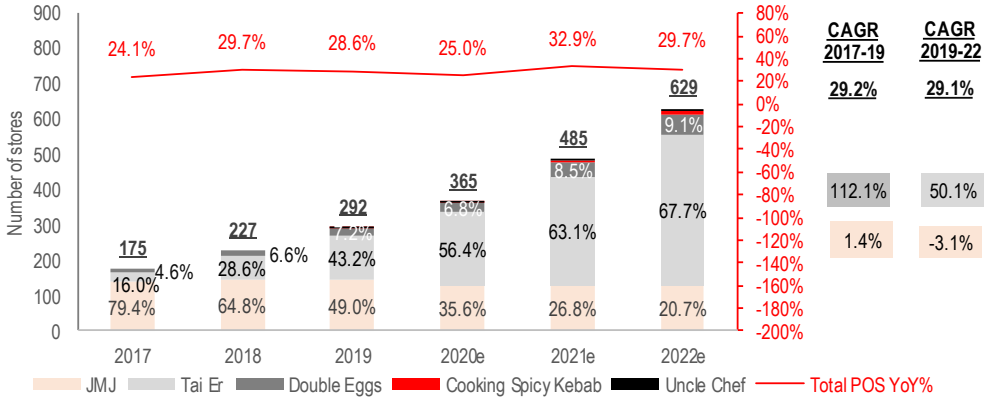
The average EV/EBITDA ratio since the IPO has been 17.7x, in a range of 10.1-26.0x. The current consensus-based one-year forward EV/EBITDA ratio is 21.8x.

Financial forecasts

Revenue forecasts

In Figure 96, we illustrate the growth in the number of restaurants by brand. Over 2019-22e, we expect the CAGR of Tai Er to be 50% and JMJ's to be -3% due to store closures.

Figure 96. Growth in the number of restaurants, by brand



Source: Company data

In Figure 97, we show the key assumptions used to derive our revenue forecasts for 2020-22e.

Owing to the impact of COVID-19, we expect revenue to drop 38.1% in 1H20e before growing 27.3% in 2H20e. Smoothing out the impact of COVID-19, we expect a revenue CAGR of 33.1% over 2019-21e, leading to a y-o-y rebound of 82.2% in 2021e revenue.

Figure 97. Revenue drivers

RMBm	2019	1H20e	2H20e	2020e	2021e	2022e	CAGR 2019-21e
Revenue	**2,687**	**766**	**1,845**	**2,612**	**4,760**	**6,439**	**33.1%**
y-o-y %	42.0%	-38.1%	27.3%	-2.8%	82.2%	35.3%	
- JiuMaoJiu	**1,348**	**290**	**562**	**852**	**1,258**	**1,316**	**-3.4%**
y-o-y %	2.1%	-56.9%	-16.8%	-36.8%	47.7%	4.6%	
Average POS y-o-y%	1.4%	-11.1%	0.3%	-5.9%	-4.8%	0.0%	
SSSG%	0.2%	-54.1%	-15.00%	-34.5%	57.8%	5.0%	
- Tai Er	**1,275**	**456**	**1,234**	**1,690**	**3,372**	**4,948**	**62.7%**
y-o-y %	135.9%	-15.1%	67.4%	32.6%	99.5%	46.7%	
Average POS y-o-y%	105.4%	67.9%	57.6%	73.8%	54.2%	43.0%	
SSSG%	4.0%	-21.2%	9.0%	-6.1%	6.5%	4.0%	
- Other brands	**33**	**9**	**29**	**38**	**87**	**131**	
Others	**32**	**11**	**20**	**31**	**42**	**44**	**14.5%**

Source: Company data, HSBC estimates

Profit forecasts

In Figure 98, we include the key assumptions to derive our restaurant margin forecasts for 2020-22e by brand. Again, to deliver our IFRS 16 adjusted restaurant margin, we have included the cost of amortisation on right-of-use assets, interest cost on lease liabilities and depreciation & amortisation.

Due to the drop in SSSG in sales and enlarged losses from newly opened restaurants, we expect a restaurant margin of 2.1% in 1H20e before bouncing back to 17.4% in 2H20e.

By brand, we expect the restaurant loss ratio to be 13.3% for JMJ in 1H20e. Tai Er should generate a positive restaurant margin of 5.5% in 1H20e, thanks to a fast recovery in sales after the stores resumed operation.

Moving into 2021e, we expect Tai Er's restaurant margin to return to 21%, similar to 2019, with JMJ's restaurant margin recovering to 15.8%, also similar to 2019.

Figure 98. Restaurant margin drivers

RMBm	2019	1H20e	2H20e	2020e	2021e	2022e	CAGR 2019-21e
Restaurant profit	**499.3**	**-15.7**	**320.6**	**304.8**	**934.2**	**1,284.8**	**36.8%**
- JiuMaoJiu & other brands	230.4	-40.7	53.5	12.8	216.4	233.0	
- Tai Er	274.5	25.0	267.0	292.0	717.7	1,051.8	61.7%
Restaurant margin	**18.6%**	**-2.1%**	**17.4%**	**11.7%**	**19.7%**	**20.0%**	
- JiuMaoJiu & other brands	16.0%	-13.3%	12.1%	1.4%	15.8%	15.8%	
- Tai Er	21.5%	5.5%	21.6%	17.3%	21.3%	21.2%	
Raw materials and consumables used	**-985**	**-288**	**-704**	**-992**	**-1,831**	**-2,509**	**36.3%**
As % of restaurant revenue	**-36.7%**	**-37.7%**	**-38.3%**	**-38.1%**	**-38.6%**	**-39.1%**	
- JiuMaoJiu & other brands	-33.0%	-33.0%	-33.0%	-33.0%	-33.0%	-33.0%	
- Tai Er	-40.9%	-40.9%	-40.9%	-40.9%	-40.9%	-40.9%	
Staff costs	**-697**	**-278**	**-455**	**-733**	**-1,103**	**-1,447**	**25.8%**
As % of restaurant revenue	**-26.0%**	**-36.4%**	**-24.7%**	**-28.2%**	**-23.3%**	**-22.5%**	
- JiuMaoJiu & other brands	-31.9%	-55.4%	-34.4%	-41.5%	-31.9%	-31.9%	
- Tai Er	-19.7%	-23.7%	-20.0%	-21.0%	-19.7%	-19.7%	
Total rental costs	**-263**	**-91**	**-205**	**-296**	**-495**	**-680**	**37.1%**
As % of restaurant revenue	**-9.8%**	**-11.9%**	**-11.1%**	**-11.4%**	**-10.4%**	**-10.6%**	
- JiuMaoJiu & other brands	-8.5%	-7.6%	-9.8%	-10.1%	-8.3%	-8.2%	
- Tai Er	-11.3%	-14.8%	-11.0%	-12.0%	-11.3%	-11.3%	
D&A	**-97**	**-60**	**-60**	**-120**	**-160**	**-212**	**28.0%**
As % of restaurant revenue	**-3.6%**	**-7.9%**	**-3.3%**	**-4.6%**	**-3.4%**	**-3.3%**	
- JiuMaoJiu & other brands	-4.2%	-3.7%	-3.0%	-3.9%	-4.2%	-4.1%	
- Tai Er	-3.0%	-10.7%	-2.9%	-5.0%	-3.0%	-3.1%	
Utilities expenses	**-108**	**-31**	**-78**	**-109**	**-185**	**-248**	**30.8%**
As % of restaurant revenue	**-4.0%**	**-4.0%**	**-4.2%**	**-4.2%**	**-3.9%**	**-3.9%**	
- JiuMaoJiu & other brands	-4.2%	-3.4%	-4.9%	-4.8%	-4.2%	-4.1%	
- Tai Er	-3.8%	-4.5%	-3.6%	-3.8%	-3.8%	-3.8%	
Delivery service fees	**-32**	**-31**	**-17**	**-48**	**-36**	**-41**	**6.5%**
As % of restaurant revenue	**-1.2%**	**-4.1%**	**-0.9%**	**-1.8%**	**-0.8%**	**-0.6%**	
- JiuMaoJiu & other brands	-2.3%	-10.2%	-2.8%	-5.3%	-2.6%	-2.8%	

Source: Company data, HSBC estimates

In Figure 99, we show our forecasts of other net profit drivers.

- A RMB113m net loss in 1H20e, with net margin rising to 7.7% in 2H20e.
- Over 2019-21e, we expect net profit and OP to grow at CAGRs of 65.2% and 59.6%, respectively, on a revenue CAGR of 33.1%.

Figure 99. Net profit drivers

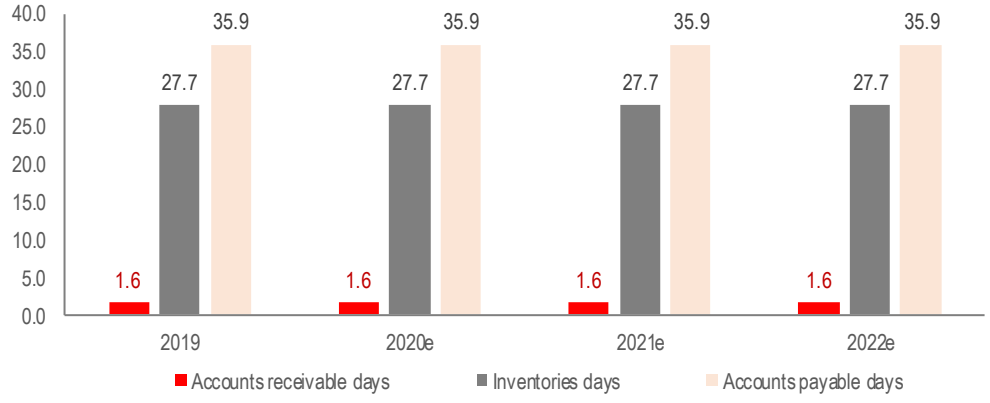
RMBm	2019	1H20e	2H20e	2020e	2021e	2022e	CAGR 2019-21e
Restaurant profit	**499.3**	**(15.7)**	**320.6**	**304.8**	**934.2**	**1,284.8**	**36.8%**
Franchising revenue	5.7	2.5	6.0	8.5	15.6	17.9	66.0%
Travelling and related expenses	-16	-7	-9	-16	-19	-21	
Listing expenses	-23	0	0	0	0	0	
Advertising and promotion expenses	-20	-9	-11	-20	-23	-26	
Other expenses: incl. transportation charges, consultation, impairment losses	-129	-70	-82	-152	-175	-201	
Share of (losses)/profits of associates	2	-1	1	0	2	2	
Other net (losses)/income: restaurant disposal gain/loss	-5	0	0	0	0	0	
Interest on lease liabilities	-60	-37	-40	-76	-90	-98	
Adjusted operating profit	**253**	**-137**	**186**	**49**	**645**	**958**	**59.6%**
y-o-y %	164.8%	-191.9%	45.9%	-82.4%	1223.8%	48.6%	
Adjusted OP margin	10.3%	-17.9%	10.1%	1.9%	13.5%	14.9%	
EBITDA	**630**	**29**	**468**	**497**	**1,345**	**1,903**	**46.1%**
y-o-y %	59.0%	-91.0%	50.8%	-21.1%	170.8%	41.5%	
EBITDA margin	23.4%	3.8%	25.4%	19.0%	28.3%	29.6%	
Other income	8	0	8	8	8	8	
Interest on bank or other borrowings	-2	19	19	39	32	31	
Effective tax rate	-28.3%	8.5%	-25.0%	-66.1%	-26.0%	-25.5%	
Minority pay-out	-11.5%	-11.5%	-11.5%	-11.5%	-11.5%	-11.5%	
Net profit	**164**	**-113**	**142**	**29**	**449**	**658**	**65.2%**
y-o-y %	136.1%	-222.0%	97.2%	-82.5%	1460.6%	46.5%	
Net margin	6.1%	-14.7%	7.7%	1.1%	9.4%	10.2%	

Source: Company data, HSBC estimates

Working capital forecasts

We expect inventory to largely be financed by trade payables in our forecast period.

Figure 100. Working capital forecast (days)



Source: Company data, HSBC estimates

Balance sheet and cash flow forecasts

Based on our forecast of a 20% dividend pay-out ratio, we expect the company to remain in a net cash position with the funds raised from its IPO. The capex for opening a new store is RMB3m for both Tai Er and JMJ.

Figure 101. Cash flow summary

RMBm	2019	2020e	2021e	2022e
Operating cash flow	**577**	**410**	**1,198**	**1,659**
- EBITDA	630	497	1,345	1,903
Capex	-184	-802	-1,166	-1,189
Dividends	**51**	**7**	**101**	**149**
- Dividend pay-out ratio %	31%	20%	20%	20%
Net cash	**-68**	**1,648**	**1,579**	**1,900**
Gross Gearing	129.2%	1.6%	1.5%	1.2%

Source: Company data, HSBC estimates

HSBC estimates vs consensus

Our net profit estimate for FY20e is 72.6% below consensus. Few analysts cover the stock, so consensus may not be representative of the latest market view.

Figure 102. HSBC vs consensus

	2020e			2021e			2022e		
RMBm	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff
Net revenue	2,612	2,887	-9.5%	4,760	4,975	-4.3%	6,439	6,683	-3.7%
Operating profit	305	323	-5.8%	934	826	13.1%	1,285	1,187	8.2%
Net profit	29	105	-72.6%	449	432	3.9%	658	621	5.9%

Source: Refinitiv Datastream, HSBC estimates

Valuation and risks

Figure 103. WACC calculation

WACC calculation	
Cost of equity	9.5%
Cost of debt	3.0%
Tax rate	25.0%
Target equity ratio	100.0%
Target debt ratio	0.0%
Risk free rate (Rf)	2.5%
Equity risk premium	5.0%
Beta	1.4
WACC	**9.5%**

Source: HSBC estimates

We initiate coverage on Jiumaojiu with a target price of HKD16.9. This gives us upside of 27.3% from the current share price and, as such, we initiate with a Buy rating.

The weighted average cost of capital (WACC) in our DCF model is 9.5% and is based on a risk-free rate of 2.5%, a market risk premium of 5.0% for China-H shares, and a company-specific beta of 1.4. The company has a very short trading history and we use 1.4 beta to reflect a lack of track record and lower liquidity. The cost of debt is 3% and the company has a 0:100 debt-to-equity ratio. We assume a 2.0% terminal growth rate.

We build our DCF valuation model until 2022e based on our financial estimates, and our semi-explicit estimates up to 2028e by using simplified assumptions, such as: 1) EBIT margin staying flat at 16.0% in 2023-28e vs 14.9% in 2022e; 2) sales growing at a 20.0% CAGR in 2021-28e vs a 33.1% CAGR in 2019-21e; 3) capex intensity as indicated by capex as a percentage of sales declining to 5.9% in 2028e from 18.5% in 2022e; and 4) the tax rate staying flat at 25.0% in the forecast period.

We use the HSBC FX team's end-2020e RMB-HKD exchange rate of 1.12. Our target price of HKD16.90 implies a 2021e PE of 41.3x and a 2022e PE of 28.2x vs an average of 48.7x since the IPO.

Figure 104. DCF valuation summary

RMBm	
+ PV 2020-2028 year cash flow	5,340
+ PV terminal value	13,799
= Enterprise value	**19,139**
+ Net cash	1,648
= Equity value	**20,787**
Shares issued (m)	1,383
Value per share (RMB)	15.03
HKD: RMB FX rate	1.122
Value per share (HKD)	**16.9**

Source: HSBC estimates

Share price catalyst: 1H20 results

Key company-specific downside risks:

- Prolonged breakeven period of new restaurants due to overexpansion
- Sauerkraut fish falling out of favour with young female customers
- Slower-than-expected store expansion due to less availability of suitable locations
- New competitor in sauerkraut fish or emerging niche segment with strong backing of capital
- Supply chain cannot keep pace with the expansion of its restaurants, leading to a deterioration in restaurant quality or services
- Share placement by VC investors

Financials & valuation: Jiumaojiu International

Buy

Financial statements

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Profit & loss summary (CNYm)				
Revenue	2,687	2,612	4,760	6,439
EBITDA	314	125	735	1,056
Depreciation & amortisation	0	0	0	0
Operating profit/EBIT	314	125	735	1,056
Net interest	-63	-38	-58	-66
PBT	259	96	686	997
HSBC PBT	259	96	686	997
Taxation	-73	-63	-178	-254
Net profit	164	29	449	658
HSBC net profit	164	29	449	658
Cash flow summary (CNYm)				
Cash flow from operations	577	410	1,198	1,659
Capex	-186	-802	-1,166	-1,189
Cash flow from investment	-190	-802	-1,166	-1,189
Dividends	0	-7	-101	-149
Change in net debt	85	-1,717	69	-321
FCF equity	391	-392	32	470
Balance sheet summary (CNYm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	323	540	910	1,158
Current assets	383	1,909	2,028	2,498
Cash & others	152	1,681	1,612	1,933
Total assets	1,654	3,610	4,285	5,096
Operating liabilities	1,236	1,478	1,955	2,278
Gross debt	220	33	33	33
Net debt	68	-1,648	-1,579	-1,900
Shareholders' funds	133	2,031	2,170	2,573
Invested capital	-682	-711	-629	-555

Ratio, growth and per share analysis

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Y-o-y % change				
Revenue	42.0	-2.8	82.2	35.3
EBITDA	95.9	-60.1	487.5	43.6
Operating profit	95.9	-60.1	487.5	43.6
PBT	148.3	-63.0	615.1	45.5
HSBC EPS	136.1	-87.4	1460.6	46.5
Ratios (%)				
Revenue/IC (x)	-4.6	-3.7	-7.1	-10.9
ROIC	-38.5	-6.1	-81.2	-132.8
ROE	101.4	2.7	21.4	27.7
ROA	16.4	2.2	14.6	17.4
EBITDA margin	11.7	4.8	15.4	16.4
Operating profit margin	11.7	4.8	15.4	16.4
EBITDA/net interest (x)	5.0	3.3	12.7	15.9
Net debt/equity	40.0	-79.6	-69.6	-68.9
Net debt/EBITDA (x)	0.2	-13.2	-2.1	-1.8
CF from operations/net debt	845.4			
Per share data (CNY)				
EPS Rep (diluted)	0.16	0.02	0.32	0.48
HSBC EPS (diluted)	0.16	0.02	0.32	0.48
DPS	0.00	0.00	0.07	0.11
Book value	0.13	1.47	1.57	1.86

Key forecast drivers

Year to	12/2019a	12/2020e	12/2021e	12/2022e
JMJ SSSG	0	-35	58	5
JMJ net add in POS	-4	-13	0	0
Tai Er SSSG	4	-6	7	4
Tai Er net add in POS	61	80	100	120
JMJ restaurant margin	16	1	16	16
Tai Er restaurant margin	21	17	21	21

Valuation data

Year to	12/2019a	12/2020e	12/2021e	12/2022e
EV/sales	5.8	5.3	2.9	2.1
EV/EBITDA	50.1	110.2	18.6	12.6
EV/IC				
PE*	73.0	576.9	37.0	25.2
PB	90.1	8.2	7.6	6.4
FCF yield (%)	2.4	-2.4	0.2	2.8
Dividend yield (%)	0.0	0.0	0.6	0.9

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2019a
GHG emission intensity*	212.3
Energy intensity*	404.5
CO_2 reduction policy	Yes
Social Indicators	**12/2019a**
Employee costs as % of revenues	25.9
Employee turnover (%)	51.4
Diversity policy	Yes

Governance Indicators	12/2019a
No. of board members	7
Average board tenure (years)	0.1
Female board members (%)	14.3
Board members independence (%)	42.9

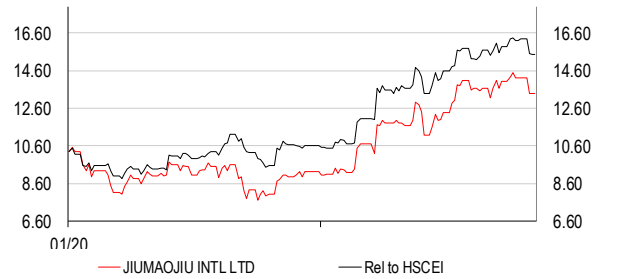
Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (HKD)	13.28	Free float	100%
Target price (HKD)	16.90	Sector	Hotels Restaurants & Leisure
RIC (Equity)	9922.HK	Country/Region	China
Bloomberg (Equity)	9922 HK	Analyst	Lina Yan
Market cap (USDm)	2,371	Contact	+852 2822 4344

Price relative



Source: HSBC

Note: Priced at close of 09 Jul 2020

Yihai (1579 HK)

- Yihai is evolving from a condiment OEM into a retail brand for the fast-growing Chinese compound condiment and instant food market
- We expect a revenue CAGR of 30% over 2019-22e, but acquisitions could power faster growth
- We initiate coverage with a Buy rating and a DCF-based target price of HKD116.40, implying 60.8x 2022e PE and 44.2x 2022e EV/EBITDA

Company description

Yihai International was founded in 2013 after a spin-off from Sichuan Haidilao to consolidate condiment product production and sales. Yihai was listed on the main board of the Hong Kong Stock Exchange in July 2016 at a market cap of USD400m. It now has a market cap of USD11.6bn, with annual revenue of USD637.8m in 2019, and a 2014-19 revenue CAGR of 53.8%.

The company is the sole supplier of hot pot condiments for Haidilao

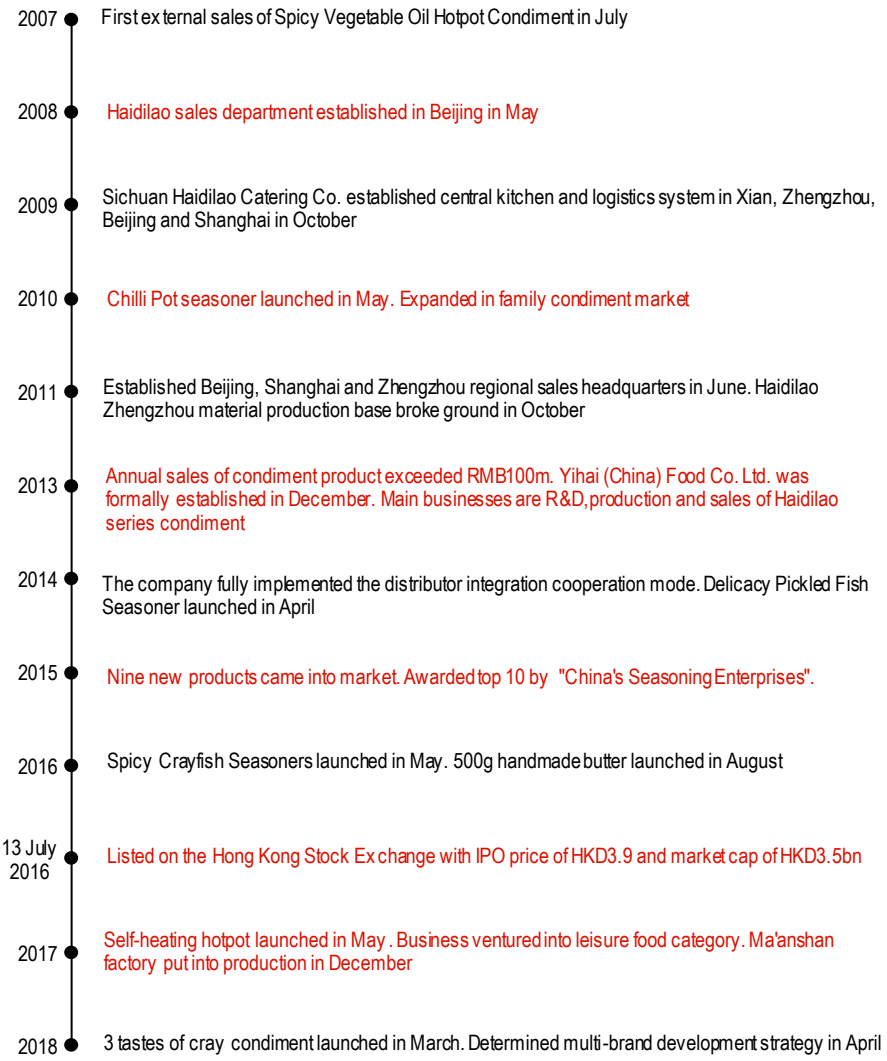
The company is the sole supplier of hot pot condiments for Haidilao. The company has the exclusive right to use the "Haidilao" brand for its condiment products on a royalty-free basis. Sales to Haidilao accounted for 14.3% of Yihai's total revenue in 2019, down from 35.2% in 2016. Besides sales to Haidilao, the company also sells through third-party distributors and e-commerce channels to family cooking customers, catering service providers and companies in the food industry. By sales channel:

- **Haidilao Group and its affiliates:** Revenue of RMB1.77bn in 2019 – 38.9% of the total – at a 2017-19 CAGR of 34.7%.
- **Third-party distributors:** Revenue of RMB2.3bn in 2019 – 53.8% of the total – at a 2017-19 CAGR of 98.1%.
- **E-commerce:** Revenue of RMB300m in 2019 – 6.4% of the total – at a 2017-19 CAGR of 61.1%.
- **Others:** Includes sales to third-party catering enterprises and one-off sales activities. Revenue of RMB40m in 2019, less than 1% of the total.

Major products include hot pot condiments, ready-to-eat products, Chinese-style compound condiments, and others, accounting for 65.7%, 23.3%, 9.2% and 1.8% of total revenue in 2019, respectively.

Timeline

Figure 105. Yihai company milestones


2007
First external sales of Spicy Vegetable Oil Hotpot Condiment in July
2008
Haidilao sales department established in Beijing in May
2009
Sichuan Haidilao Catering Co. established central kitchen and logistics system in Xian, Zhengzhou, Beijing and Shanghai in October
2010
Chilli Pot seasoner launched in May. Expanded in family condiment market
2011
Established Beijing, Shanghai and Zhengzhou regional sales headquarters in June. Haidilao Zhengzhou material production base broke ground in October
2013
Annual sales of condiment product exceeded RMB100m. Yihai (China) Food Co. Ltd. was formally established in December. Main businesses are R&D, production and sales of Haidilao series condiment
2014
The company fully implemented the distributor integration cooperation mode. Delicacy Pickled Fish Seasoner launched in April
2015
Nine new products came into market. Awarded top 10 by "China's Seasoning Enterprises".
2016
Spicy Crayfish Seasoners launched in May. 500g handmade butter launched in August
13 July 2016
Listed on the Hong Kong Stock Exchange with IPO price of HKD3.9 and market cap of HKD3.5bn
2017
Self-heating hotpot launched in May. Business ventured into leisure food category. Ma'anshan factory put into production in December
2018
3 tastes of cray condiment launched in March. Determined multi-brand development strategy in April

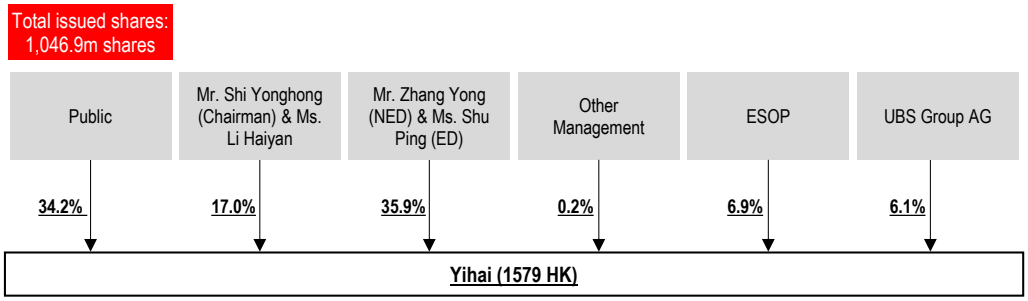
Source: Company data

Board of directors and shareholder structure

Yihai's board comprises five executive directors, one non-executive director and three independent non-executive directors with a term of three years. Mr. Shi Yonghong is the Chairman and Mr. Guo Qiang is the CEO and executive director.

Mr. Shi and his spouse hold 17.02% of the shares and non-executive director Mr. Zhang Yong and his spouse 35.9%. The employee share option plan (ESOP) has a 6.9% interest and other members of the management team hold 0.2%.

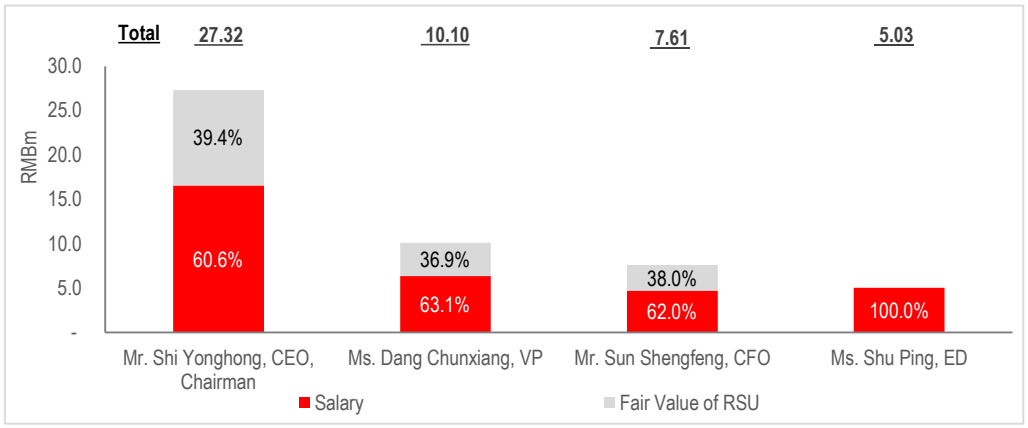
Figure 106. Shareholder structure



Source: Company data

The figure below shows the total compensation of top executives in 2019.

Figure 107. Yihai executive compensation



Source: Company data

Investment thesis

From OEM to a retail brand. Yihai started as the supplier of hot pot condiments to its related party, Haidilao, but later grew its market share in the retail market for hot pot condiments, Chinese compound condiments and instant hot pot. In 2019, sales to Haidilao accounted for 37.2% of revenue, down from 53.7% in 2016. Sales of its retail products accounted for 61.2% of revenue, up from 44.3% in 2016. Based on Euromonitor data, Yihai's market share in Chinese compound condiments was 22% in 2019, up from 8% in 2015 and its market share in ready meals was 6%, up from 0% in 2016. We believe the transformation to a retail brand will continue to drive its growth and valuation.

Acquisitions might fuel faster growth. Over 2019-22e we expect Yihai to deliver a net profit CAGR of 30.3% on a 29.8% revenue CAGR. Although it is a manufacturer, the company's business model is quite asset light: annual operating cash inflow of RMB1-1.5bn vs capex of RMB250m. The success of its distribution channel is the main reason for its success of its retail products. Yihai started to revamp its third-party distributor channel in 2017 by eliminating the agent level. After that, revenue from this channel grew at a CAGR of 98.1% over 2017-19. If Yihai uses its excess cash to make acquisitions, then we believe it can replicate its success and fuel faster growth than through organic expansion.

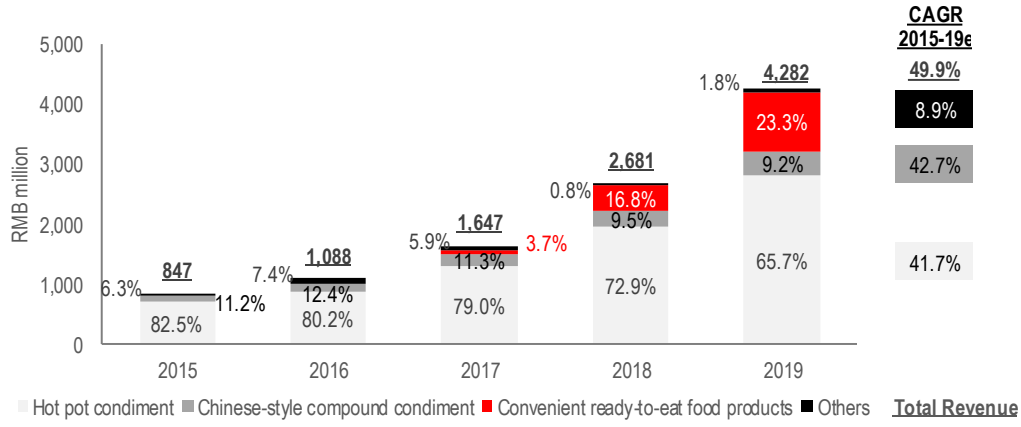
Initiate with a Buy rating with a TP of HKD116.40. We use a DCF model to set our TP based on a WACC of 7.5% and terminal growth rate of 3.5%. Our TP implies a 2021e PE of 77.1x.

Financial review

Revenue drivers

In Figure 108, we illustrate the top-line drivers for Yihai over 2015-19 by product category. Hot pot condiment's contribution to total group revenue dropped to 65.7% in 2019 from 82.5% in 2015 (CAGR of 41.7%). Chinese-style compound condiments contributed 9.2% to revenue in 2019, down from 11.2% in 2015 (CAGR of 42.7%). Ready-to-eat products, a new category started in 2017, accounted for 23.3% of revenue in 2019. The group's revenue CAGR over 2015-19 was 49.9%.

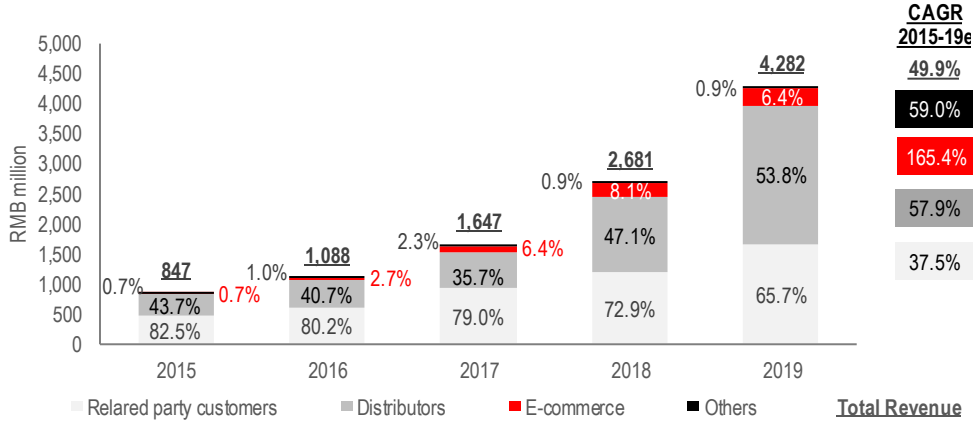
Figure 108. Top-line drivers by product category



Source: Company data

- By channel, revenue from sales to related parties dropped to 38.8% in 2019, from 54.9% in 2015 (CAGR 37.5%).
- The third-party distributor channel contributed to 53.8% of revenue in 2019, up from 43.7% in 2015 (CAGR 57.9%).
- E-commerce contributed to 6.4% of revenue in 2019, up from 0.7% in 2015.

Figure 109. Top-line drivers by channel



Source: Company data

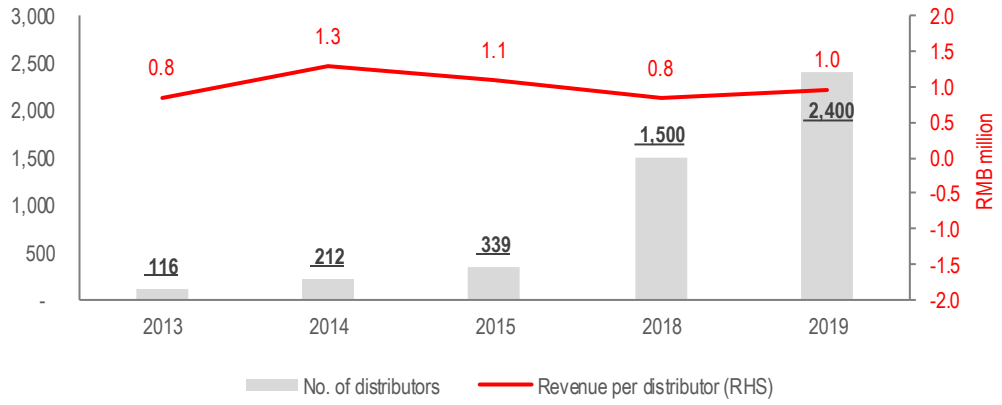
The revamp of the distributor channel

Yihai started to reform its third-party distributor channel in 2017 by eliminating the agent level. After that, revenue from the channel grew at a 98.1% CAGR over 2017-19.

In Figure 110, we show the growth in its distributors. Not only did the company try to deepen penetration by directly establishing relationships with retail distributors, it also started to implement "zero inventory" in hypermarkets from 2019 in order to avoid channel stuffing. Yihai established six regional logistics centres so distributors could replenish their orders more frequently (every two weeks).

In 2020, the company plans to improve the efficiency of the channel by upgrading its existing "partner" incentive mechanism. The aim is to motivate all the sales partners to train new talent and share the benefits, creating greater value as a team.

Figure 110. The growth in distributors

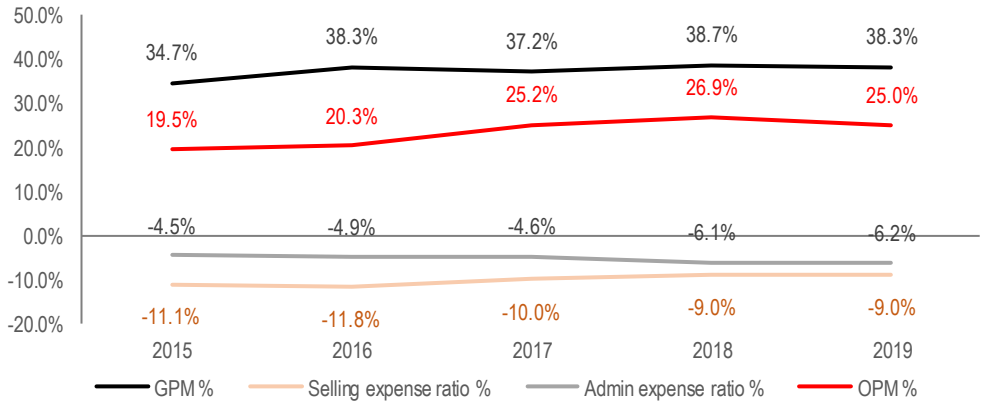


Source: Company data

Historical margins

Figure 111 shows the company's historical margin trends – GPM, selling cost ratio, admin cost ratio and OP margin.

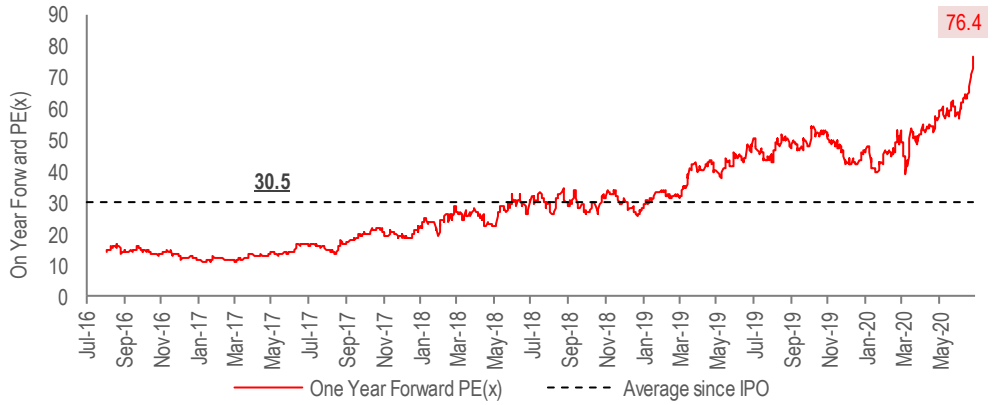
Figure 111. Margin trend, 2016-19



Source: Company data

Historical valuation

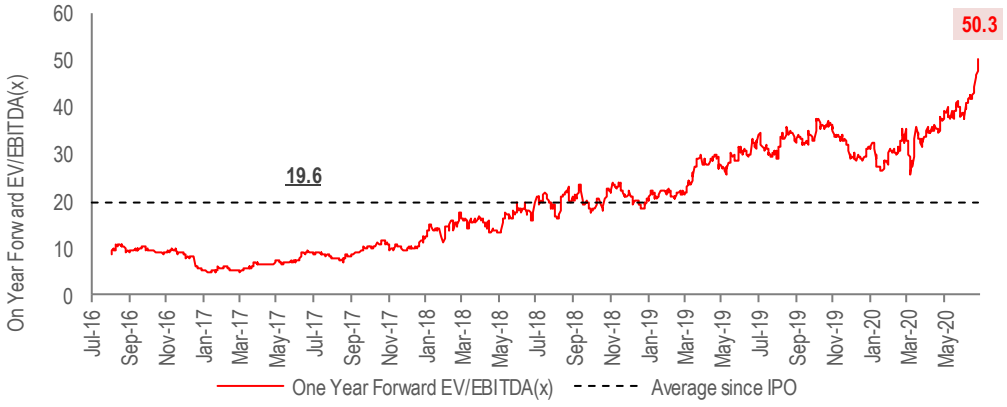
Figure 112. Yihai one-year forward PE



Source: Bloomberg

Yihai shares started trading on the Hong Kong Stock Exchange on 13 July 2016. Since then, the stock has traded at an average one-year forward PE of 30.4x, in a range of 10.9-76.4x. The shares now trade at a consensus one-year forward PE of 76.4x.

Figure 113. Yihai one-year forward EV/EBITDA



Source: Bloomberg

The average EV/EBITDA ratio since the IPO is 19.4x, in a range of 4.7-42.5x. The current consensus-based one year forward EV/EBITDA ratio is 42.5x.

Financial forecasts

Revenue forecasts

During the COVID-19 outbreak in 1H20, we estimate the company's instant hot pot sales more than doubled. But at the same time, sales of hot pot condiments were hit hard by the closure of Haidilao hot pot restaurants. We estimate hot pot condiment sales to Haidilao dropped 27% in 1H20e.

However, in terms of its overall hot pot condiment business we expect revenue to drop by only 9.3% in 1H20e thanks to the growth in retail hot pot condiment sales during the lockdown period

for home use. We also expect the sales of Chinese style compound condiments to benefit from the rise in home cooking. Overall, we expect its revenue to grow by 24.3% in 1H20e.

In 2H20, the tailwinds from rising demand for home cooking and instant hot pot should diminish. However, given the recovery in the hot pot condiment sales to Haidilao and the benefits of distribution channel reform continuing, we expect revenue in 2H20e to grow 27.6% y-o-y.

Looking ahead to 2021e, we expect the recovery in hot pot condiment sales to support 35% growth in revenue.

Figure 114. Revenue drivers

RMBm	2019	1H20	2H20	2020e	2021e	2022e	CAGR (2019-21e)
Total revenue	**4,282**	**2,058**	**3,353**	**5,411**	**7,384**	**9,375**	**31.3%**
y-o-y %	59.7%	24.3%	27.6%	26.4%	36.5%	27.0%	
- Related parties	1,663	525	1,195	1,720	3,125	3,907	37.1%
y-o-y %	41.4%	-25.9%	25.1%	3.4%	81.7%	25.0%	
- Third parties	2,619	1,533	2,158	3,691	4,259	5,468	27.5%
y-o-y %	74.0%	61.8%	29.1%	40.9%	15.4%	28.4%	
Hot pot condiment	**2,813**	**987**	**2,116**	**3,102**	**4,790**	**5,913**	**30.5%**
y-o-y %	43.9%	-9.3%	22.6%	10.3%	54.4%	23.4%	
Chinese-style compound condiment	**395**	**285**	**243**	**529**	**681**	**877**	**31.3%**
y-o-y %	54.6%	42.7%	24.8%	33.9%	28.7%	28.9%	
Convenient ready-to-eat food products	**999**	**739**	**931**	**1,670**	**1,770**	**2,400**	**33.1%**
y-o-y %	122.4%	116.6%	41.6%	67.2%	6.0%	35.6%	
Others	**75**	**48**	**63**	**110**	**143**	**186**	**37.9%**

Source: Company data, HSBC estimates

GPM drivers

In Figure 115, we show GPM by category. The y-o-y change in GPM by category is mainly driven by the mix shift between sales from retail products and sales to related parties. In 2019, GPM for sales to related parties was 27.5% and to third parties 45.2%.

Figure 115. GPM drivers

	2019	1H20	2H20	2020e	2021e	2022e	CAGR (2019-21e)
GPM	**38.3%**	**38.5%**	**38.3%**	**38.4%**	**37.1%**	**36.9%**	**29.2%**
ppts change y-o-y	-0.4%	0.9%	-0.4%	0.1%	-1.3%	-0.2%	
- Related parties	27.5%	27.9%	28.0%	28.0%	28.0%	28.0%	38.2%
ppts change y-o-y	0.1%	1.1%	0.0%	0.5%	0.0%	0.0%	
- Third parties	45.2%	42.2%	44.0%	43.2%	43.8%	43.2%	25.6%
ppts change y-o-y	-2.4%	-3.6%	-0.9%	-2.0%	1.6%	-0.7%	
Hot pot condiment	39.7%	41.1%	40.4%	40.6%	37.8%	37.5%	27.3%
ppts change y-o-y	0.4%	3.3%	-0.5%	0.9%	-3.3%	-2.9%	
Chinese-style compound condiment	46.9%	48.7%	47.0%	47.9%	48.1%	48.3%	33.0%
ppts change y-o-y	-2.2%	0.9%	1.0%	1.0%	-0.6%	1.3%	
Convenient ready-to-eat food products	32.7%	32.7%	32.7%	32.7%	32.7%	32.7%	33.1%
ppts change y-o-y	1.8%	-0.1%	0.0%	0.0%	0.0%	0.0%	
Others	16.6%	16.6%	16.6%	16.6%	16.6%	16.6%	37.9%
ppts change y-o-y	-11.6%	-3.4%	1.9%	0.0%	0.0%	0.0%	

Source: Company data, HSBC estimates

Profit forecasts

In Figure 116, we include the key assumptions for our net profit forecasts. We expect OP and net profit to deliver CAGRs of 30.4% and 32.1% in 2019-21e on a 31.3% revenue CAGR.

Figure 116. Net profit drivers

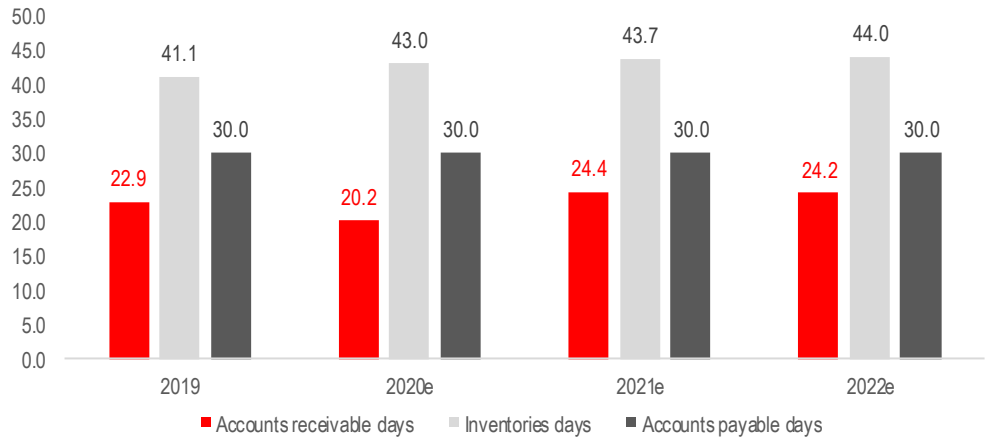
RMBm	2019	1H20	2H20	2020e	2021e	2022e	CAGR (2019-21e)
GP	**1,641**	**793**	**1,284**	**2,077**	**2,740**	**3,457**	**29.2%**
Other income	79	32	47	79	79	79	0.0%
Selling expenses	-383	-179	-254	-433	-554	-656	20.2%
as % of Rev	-9.0%	-8.7%	-7.6%	-8.0%	-7.5%	-7.0%	
Admin expenses	-266	-134	-191	-325	-443	-562	29.2%
as % of Rev	-6.2%	-6.5%	-5.7%	-6.0%	-6.0%	-6.0%	
OP	**1,072**	**513**	**886**	**1,399**	**1,822**	**2,317**	**30.4%**
OPM %	25.0%	24.9%	26.4%	25.9%	24.7%	24.7%	
EBITDA	1,114	513	886	1,457	1,897	2,408	30.5%
EBITDA margin %	26.0%	24.9%	26.4%	26.9%	25.7%	25.7%	
Finance income/(expenses), net	22	15	15	34	45	57	42.6%
Effective tax rate %	27.3%	24.2%	27.2%	26.0%	26.0%	26.0%	
Minority payout %	9.6%	14.3%	10.7%	12.0%	9.2%	9.4%	
Net profit	**719**	**343**	**585**	**932**	**1,254**	**1,591**	**32.1%**
NIM %	16.8%	16.6%	17.5%	17.2%	17.0%	17.0%	

Source: Company data, HSBC estimates

Working capital forecasts

Figure 117 shows our working capital forecasts. We expect inventory days to gradually go up due to the rising contribution of sales from the third-party distributor channel, which has longer inventory days than sales to related parties.

Figure 117. Working capital forecast (days)



Source: Company data, HSBC estimates

Balance sheet and cash flow forecasts

Based on our forecast of a 30% dividend pay-out ratio, we expect the company to remain in a net cash position. Capex is expected to be RMB250m pa, mainly for building the new production capacity.

Figure 118. Cash flow summary

RMBm	2019	2020e	2021e	2022e
Operating cash flow	**951**	**1,069**	**1,235**	**1,704**
- EBITDA	1,114	1,457	1,897	2,408
Capex	-273	-250	-250	-250
Dividends	216	280	376	477
- Dividend pay-out ratio	30%	30%	30%	30%
Net cash	1,611	2,150	2,758	3,735
Net Gearing	-59.0%	-60.3%	-59.5%	-62.4%

Source: Company data, HSBC estimates

HSBC estimates vs consensus

Our estimates are generally in line with consensus.

Figure 119. HSBC vs consensus

RMBm	2020e			2021e			2022e		
	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff
Net revenue	5,411	5,606	-3.5%	7,384	7,521	-1.8%	9,375	9,627	-2.6%
Operating profit	1,399	1,396	0.2%	1,822	1,878	-3.0%	2,317	2,425	-4.4%
Net profit	932	948	-1.6%	1,254	1,272	-1.4%	1,591	1,646	-3.3%

Source: Refinitiv Datastream, HSBC estimates

Valuation and risks

Figure 120. WACC calculation

WACC calculation	
Cost of equity	7.5%
Cost of debt	3.0%
Tax rate	25.0%
Target equity ratio	100.0%
Target debt ratio	0.0%
Risk free rate (Rf)	2.5%
Equity risk premium	5.0%
Beta	1.00
WACC	7.5%

Source: HSBC estimates

We initiate coverage on Yihai with a target price of HKD116.40. This gives us upside of 22.2% from the current share price and, as such, we initiate with a Buy rating.

The weighted average cost of capital (WACC) in our DCF model is 7.5% and is based on a risk-free rate of 2.5%, a market risk premium of 5.0% for China-H shares, and a company-specific beta of 1.0. The cost of debt is 3% and the company has a 0:100 debt-to-equity ratio. We assume a 3.5% terminal growth rate, which is in-line with the rate of food inflation in China.

We build our DCF valuation model until 2022e based on our financial estimates, and build semi-explicit estimates up to 2028e by using simplified assumptions such as: 1) EBIT margin increasing to 26.0% in 2028e from 24.7% in 2022e; 2) sales growing at a 24.3% CAGR in 2021-28e vs a 31.3% CAGR in 2019-21e; 3) capex intensity as indicated by capex as a percentage of sales further declining to 0.3% in 2028e from 2.7% in 2022e; and 4) the tax rate staying flat at 25.0% in the forecast period.

We use the HSBC FX team's end-2020e RMB-HKD exchange rate of 1.12. Our target price of HKD116.40 implies a 2021e PE of 77.1x and a 2022e PE of 60.8x vs an average of 30.2x since the IPO. We believe a re-rating above its historical trading range is likely as a result of its strong market share gain in the much bigger retail market for instant food (ready meals) and Chinese compound condiments.

Figure 121. DCF valuation summary

RMBm	New
+ PV 2020-28e year cash flow	17,083
+ PV terminal value	89,315
= Enterprise value	**106,398**
+ Net cash	2,150
= Equity value	**108,548**
Shares issued (m)	1,047
Value per share (RMB)	103.69
HKD: RMB FX rate	1.122
Value per share (HKD)	**116.40**

Source: HSBC estimates

Share price catalyst: 1H20 results

Key company-specific downside risks:

- Slower-than-expected growth in the instant food category
- The costs under its distribution channel get out of control due to rising competition, excessive inventory in the channel or unstable retail prices
- Lower-than-expected profitability for transactions with related parties
- Slower-than-expected production capacity ramp-up to support its revenue growth
- Lower-than-expected GPM due to lack of pricing power to pass-on rising raw material costs to customers

Financials & valuation: Yihai International

Buy

Financial statements

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Profit & loss summary (CNYm)				
Revenue	4,282	5,411	7,384	9,375
EBITDA	1,126	1,477	1,924	2,443
Depreciation & amortisation	-55	-78	-102	-125
Operating profit/EBIT	1,072	1,399	1,822	2,317
Net interest	22	34	45	57
PBT	1,094	1,433	1,867	2,375
HSBC PBT	1,094	1,433	1,867	2,375
Taxation	-299	-372	-486	-617
Net profit	719	932	1,254	1,591
HSBC net profit	719	932	1,254	1,591
Cash flow summary (CNYm)				
Cash flow from operations	951	1,069	1,235	1,704
Capex	-255	-250	-250	-250
Cash flow from investment	-947	-250	-250	-250
Dividends	-21,559	-27,974	-37,623	-47,736
Change in net debt	144	-539	-609	-976
FCF equity	697	819	985	1,454
Balance sheet summary (CNYm)				
Intangible fixed assets	169	218	260	294
Tangible fixed assets	704	898	1,077	1,239
Current assets	2,354	3,020	3,985	5,245
Cash & others	1,036	1,575	2,184	3,160
Total assets	3,312	4,221	5,406	6,863
Operating liabilities	583	656	774	882
Gross debt	0	0	0	0
Net debt	-1,036	-1,575	-2,184	-3,160
Shareholders' funds	2,614	3,322	4,262	5,445
Invested capital	1,607	1,904	2,364	2,736

Ratio, growth and per share analysis

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Y-o-y % change				
Revenue	59.7	26.4	36.5	27.0
EBITDA	51.4	31.2	30.3	27.0
Operating profit	48.7	30.5	30.3	27.2
PBT	49.7	31.0	30.3	27.2
HSBC EPS	39.7	20.2	34.5	26.9
Ratios (%)				
Revenue/IC (x)	3.5	3.1	3.5	3.7
ROIC	64.4	59.9	64.2	68.4
ROE	31.1	31.4	33.1	32.8
ROA	27.0	27.5	28.0	28.0
EBITDA margin	26.3	27.3	26.1	26.1
Operating profit margin	25.0	25.9	24.7	24.7
EBITDA/net interest (x)				
Net debt/equity	-38.0	-44.2	-47.1	-52.8
Net debt/EBITDA (x)	-0.9	-1.1	-1.1	-1.3
CF from operations/net debt				
Per share data (CNY)				
EPS Rep (diluted)	0.74	0.89	1.20	1.52
HSBC EPS (diluted)	0.74	0.89	1.20	1.52
DPS	0.21	0.27	0.36	0.46
Book value	2.50	3.17	4.07	5.20

Key forecast drivers

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Hot pot condiment Revenue YoY%	44	10	54	23
Chinese-style compound condiment Revenue YoY%	55	34	29	29
Convenient ready-to-eat food products Revenue YoY%	122	67	6	36
GPM %	38	38	37	37

Valuation data

Year to	12/2019a	12/2020e	12/2021e	12/2022e
EV/sales	20.8	16.3	11.9	9.3
EV/EBITDA	79.0	59.9	45.6	35.5
EV/IC	55.3	46.4	37.2	31.7
PE*	116.1	96.6	71.8	56.6
PB	34.5	27.1	21.1	16.5
FCF yield (%)	0.8	0.9	1.1	1.6
Dividend yield (%)	23.9	31.1	41.8	53.0

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2019a
GHG emission intensity*	0.0
Energy intensity*	130.3
CO_2 reduction policy	Yes
Social Indicators	**12/2019a**
Employee costs as % of revenues	10.6
Employee turnover (%)	30.5
Diversity policy	Yes

Governance Indicators	12/2019a
No. of board members	9
Average board tenure (years)	3.2
Female board members (%)	33.3
Board members independence (%)	33.3

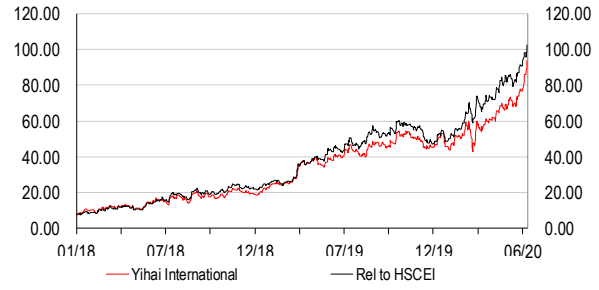
Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (HKD)	95.25	Free float	100%
Target price (HKD)	116.40	Sector	Hotels Restaurants & Leisure
RIC (Equity)	1579.HK	Country/Region	China
Bloomberg (Equity)	1579 HK	Analyst	Lina Yan
Market cap (USDm)	12,867	Contact	+852 2822 4344

Price relative



Source: HSBC

Note: Priced at close of 09 Jul 2020

Yum China (YUMC US)

- We expect Yum China to deliver a 7.5% CAGR in revenue (10% for KFC) and 16% CAGR in adjusted net profit over 2019-21e
- The growth trajectory is highly visible and we expect improving ROIC to continue to support returns to shareholders
- Reiterate Buy rating with unchanged DCF-based TP of USD58, implying 2021e PE of 24.3x and EV/EBITDA of 11.7x; all estimates unchanged

Earnings estimates

Figure 122. Yum China forecast summary

	2019	2020e	2021e	2022e	CAGR (2019-21e)
Revenues	**8,776**	**7,921**	**10,146**	**11,257**	**7.5%**
YoY%	4.3%	-9.7%	28.1%	10.9%	
YoY%, ex FX	9.0%	-7.5%	26.8%	10.9%	
KFC	**6,040**	**5,609**	**7,335**	**8,292**	**10.2%**
YoY%	6.2%	-7.1%	30.8%	13.0%	
Pizza Hut	**2,054**	**1,638**	**2,073**	**2,183**	**0.5%**
YoY%	-2.7%	-20.2%	26.5%	5.3%	
Other brands	**158**	**156**	**214**	**257**	**16.5%**
Corporate and unallocated	**562**	**550**	**562**	**562**	
Elimination	**-38**	**-33**	**-38**	**-38**	
Reported Operating Profit	**901**	**662**	**1,199**	**1,363**	**15.4%**
YoY%	-4.3%	-26.6%	81.3%	13.6%	
YoY%, ex FX	0.5%	-24.3%	80.0%	13.6%	
OPM%	11.4%	9.3%	13.0%	13.3%	
KFC	**15.7%**	**14.3%**	**17.5%**	**17.6%**	
Pizza Hut	**5.6%**	**-0.8%**	**4.2%**	**4.5%**	
Other Segments	**-8.9%**	**-11.6%**	**-6.5%**	**-5.4%**	
Adjusted Reported Operating Profit	**912**	**662**	**1,199**	**1,363**	**14.7%**
YoY%	6.7%	-27.4%	81.3%	13.6%	
YoY%, ex FX	11.4%	-25.2%	80.0%	13.6%	
Adjusted OPM %	11.5%	9.3%	13.0%	13.3%	
PBT	1,003	698	1,255	1,424	**11.9%**
YoY%	5.6%	-30.4%	79.7%	13.5%	
PBT Margin	11.4%	8.8%	12.4%	12.7%	
Net Income (Loss)	**713**	**491**	**899**	**1,020**	**12.3%**
YoY%	0.7%	-31.2%	83.1%	13.5%	
Net Margin	8.1%	6.2%	8.9%	9.1%	
Adjusted NI excluding Meituan mark-to-market	**666**	**491**	**899**	**1,020**	**16.2%**
YoY%	5.2%	-26.3%	83.1%	13.5%	
YoY ex. FX	9.9%	-24.1%	81.8%	13.5%	

Source: Company data, HSBC estimates

HSBC vs consensus

Figure 123. HSBC vs consensus

RMBm	2020e			2021e			2022e		
	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff	HSBC estimates	Consensus	% diff
Net revenue	7,921	8,128	-2.5%	10,146	9,579	5.9%	11,257	10,435	7.9%
Operating profit	662	567	16.8%	1,199	1,050	14.2%	1,363	1,178	15.7%
Net profit	491	410	19.7%	899	783	14.8%	1,020	889	14.7%

Source: Refinitiv Datastream, HSBC estimates

Valuation and risks

Figure 124. DCF summary

	RMBm
+ PV 2020-29e year cash flow	5,568
+ PV terminal value	13,924
= Enterprise value	**19,492**
+ Net cash	2,345
- Fair value of minorities	(98)
= Equity value	**21,739**
Shares issued (m)	377
Value per share (USD)	**58.0**

Source: HSBC estimates

Our DCF-based TP is USD58 and is based on unchanged WACC of 6.6%. Our DCF valuation model until 2022e is based on our explicit forecasts and then we build in semi-explicit forecasts up to 2029e by using simplified assumptions on the DCF lines, such as: 1) EBIT margin remaining flat at 12.1% over the semi-explicit period; 2) sales growing at a 6% CAGR over the 2022-28e period vs 19.2% CAGR over 2020-22e; 3) capex intensity − as indicated by capex as a percentage of sales − declining to 2.4% in 2029e from 6.3% in 2020e; and 4) the tax rate staying flat at 25.0% throughout the semi-explicit forecast period, all assumptions remaining unchanged.

Our DCF uses an unchanged WACC of 6.6% and is based on a risk-free rate of 2.5%, risk premium of 5.0%, cost of debt of 5.0%, beta of 0.9 and debt-equity ratio of 12:88. We use an unchanged 2.0% terminal growth rate, assuming that long-term growth will be driven by new formats, which should grow in line with CPI.

Our TP implies a 2021e EV/EBITDA of 11.7x vs the average EV/EBITDA of 10.2x (range 7.3-16.1x) since the IPO in 2016.

Our USD58 TP implies 13.5% upside. We retain our Buy rating as we believe a better-than-expected recovery in dine-in activities will drive further upside to its earnings and valuation. In our view, this is possible given the relatively good control of COVID-19 new cases in Mainland China.

Downside risks

- Lower-than-expected store openings, aggressive development could cannibalise existing sales and new restaurants may not be profitable.
- The company may miss its SSSG due to rising competition.
- Labour costs account for 22-23% of the company's restaurant revenue. Failure to manage labour productivity gains might negatively impact margins.
- Poultry represents c40% of the cost of sales for KFC. Inflation in poultry prices would affect overall COGS.
- Fluctuation in the value of the RMB may have a material adverse effect on reported earnings in USD terms.
- The prolonged impact of the coronavirus outbreak.

Financials & valuation: Yum China

Buy

Financial statements

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Profit & loss summary (USDm)				
Revenue	8,776	7,921	10,146	11,257
EBITDA	1,329	1,068	1,611	1,769
Depreciation & amortisation	-428	-406	-411	-407
Operating profit/EBIT	901	662	1,199	1,363
Net interest	39	37	55	62
PBT	1,003	698	1,255	1,424
HSBC PBT	1,003	698	1,255	1,424
Taxation	-260	-184	-314	-356
Net profit	713	491	899	1,020
HSBC net profit	729	491	899	1,020
Cash flow summary (USDm)				
Cash flow from operations	1,185	1,301	1,458	1,535
Capex	-435	-500	-500	-500
Cash flow from investment	-910	-500	-500	-500
Dividends	-181	-181	-181	-181
Change in net debt	-269	-688	-736	-807
FCF equity	275	801	958	1,035
Balance sheet summary (USDm)				
Intangible fixed assets	348	339	330	321
Tangible fixed assets	4,254	4,667	5,225	5,943
Current assets	2,259	2,913	3,703	4,773
Cash & others	1,657	2,345	3,080	3,887
Total assets	6,950	8,008	9,347	11,126
Operating liabilities	3,775	4,140	4,444	5,037
Gross debt	0	0	0	0
Net debt	-1,657	-2,345	-3,080	-3,887
Shareholders' funds	3,077	3,770	4,805	5,990
Invested capital	1,101	1,162	1,512	1,959

Ratio, growth and per share analysis

Year to	12/2019a	12/2020e	12/2021e	12/2022e
Y-o-y % change				
Revenue	4.3	-9.7	28.1	10.9
EBITDA	-4.1	-19.7	50.9	9.8
Operating profit	-4.3	-26.6	81.3	13.6
PBT	5.6	-30.4	79.7	13.5
HSBC EPS	22.5	-30.7	83.1	13.5
Ratios (%)				
Revenue/IC (x)	7.7	7.0	7.6	6.5
ROIC	58.4	43.1	67.3	58.9
ROE	24.5	14.3	21.0	18.9
ROA	12.9	6.9	10.8	10.4
EBITDA margin	15.1	13.5	15.9	15.7
Operating profit margin	10.3	8.4	11.8	12.1
EBITDA/net interest (x)				
Net debt/equity	-52.2	-60.6	-62.8	-63.8
Net debt/EBITDA (x)	-1.2	-2.2	-1.9	-2.2
CF from operations/net debt				
Per share data (USD)				
EPS Rep (diluted)	1.84	1.30	2.38	2.71
HSBC EPS (diluted)	1.88	1.30	2.38	2.71
DPS	0.48	0.48	0.48	0.48
Book value	8.16	10.00	12.75	15.89

Key forecast drivers

Year to	12/2019a	12/2020e	12/2021e	12/2022e
SSSG	3	-7	15	3
Growth in POS	8	7	9	10
Restaurant Margin - Overall	16	13	17	18
Restaurant Margin - KFC	18	16	19	20
Restaurant Margin - Pizza Hut	11	5	10	10
Effective Tax Rate	26	26	25	25

Valuation data

Year to	12/2019a	12/2020e	12/2021e	12/2022e
EV/sales	2.0	2.2	1.6	1.4
EV/EBITDA	13.3	16.0	10.1	8.8
EV/IC	16.1	14.7	10.8	7.9
PE*	27.4	39.5	21.6	19.0
PB	6.3	5.1	4.0	3.2
FCF yield (%)	1.4	4.1	4.9	5.3
Dividend yield (%)	0.9	0.9	0.9	0.9

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2019a
GHG emission intensity*	222.9
Energy intensity*	327.1
CO_2 reduction policy	Yes
Social Indicators	**12/2019a**
Employee costs as % of revenues	20.6
Employee turnover (%)	n/a
Diversity policy	Yes

Governance Indicators	12/2019a
No. of board members	12
Average board tenure (years)	2.8
Female board members (%)	16.7
Board members independence (%)	83.3

Source: Company data, HSBC

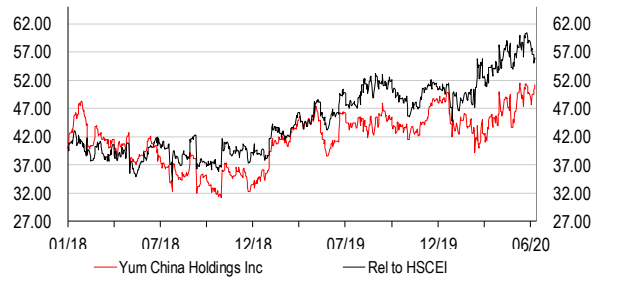
* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (USD)	51.48
Target price (USD)	58.00
RIC (Equity)	YUMC.N
Bloomberg (Equity)	YUMC US
Market cap (USDm)	19,379

Free float	100%
Sector	Hotels Restaurants & Leisure
Country/Region	China
Analyst	Lina Yan
Contact	+852 2822 4344

Price relative



Source: HSBC

Note: Priced at close of 09 Jul 2020

Figure 125. Global catering comp sheet

Company	BLM code	CY end	Mkt cap USDm	Ccy	Price 9-Jul	HSBC TP	HSBC Rating	EV/EBITDA (x) CY19	EV/EBITDA (x) CY20e	EV/EBITDA (x) CY21e	PE (x) CY19	PE (x) CY20e	PE (x) CY21e	P/Sales (x) CY19	P/Sales (x) CY20e	P/Sales (x) CY21e	Share performance YTD	Share performance 1M	Share performance 12M
Mainland China Casual Dining																			
Haidilao	**6862 HK**	**Dec**	**24,175**	**HKD**	**35.35**	**27.40**	**Reduce**	**36.8**	**59.2**	**20.0**	**72.2**	**300.0**	**40.6**	**6.5**	**6.3**	**3.6**	**13%**	**-8%**	**8%**
Jiumaojiu	**9922 HK**	**Dec**	**2,371**	**HKD**	**13.28**	**16.90**	**Buy**	**50.1**	**110.2**	**18.6**	**73.0**	**576.9**	**37.0**	**6.2**	**6.3**	**3.5**	**n/a**	**-2%**	**n/a**
Guangzhou Restaurant	603043 CH	Dec	1,900	CNY	32.86	N.R.	N.R.	n/a	28.2	20.7	33.5	30.6	23.3	4.4	3.7	3.0	8%	2%	3%
Xiabuxiabu	520 HK	Dec	1,181	HKD	8.46	N.R.	N.R.	6.8	6.3	3.7	21.0	45.6	15.3	1.4	1.4	1.0	-17%	0%	-28%
Casual Dining Mainland China Average								**32.5**	**53.5**	**16.3**	**50.2**	**38.1**	**29.2**	**4.6**	**4.4**	**2.8**	**1%**	**-2%**	**-5%**
International Casual Dining																			
Darden	DRI US	May	9,497	USD	73.12	N.R.	N.R.	10.7	12.3	8.8	18.4	25.4	16.1	1.2	1.2	1.1	-33%	-14%	-41%
Skylark	3197 JP	Dec	3,060	JPY	1,662.00	N.R.	N.R.	7.9	10.6	8.1	34.6	n/a	48.6	0.9	1.0	0.9	-22%	-9%	-12%
Texas Roadhouse	TXRH US	Dec	3,400	USD	49.06	N.R.	N.R.	10.1	30.0	11.4	19.9	n/a	23.4	1.2	1.4	1.2	-13%	-19%	-9%
Wingstop	WING US	Dec	4,163	USD	140.73	N.R.	N.R.	78.3	63.5	54.8	192.8	135.8	114.8	20.9	18.0	16.2	63%	22%	49%
Cracker Barrel	CBRL US	Jul	2,446	USD	103.23	N.R.	N.R.	8.2	11.5	7.8	16.2	31.3	17.2	0.9	0.9	0.8	-33%	-22%	-40%
Sushiro Global	3563 JP	Sep	2,781	JPY	2,571.00	N.R.	N.R.	16.6	14.7	11.6	31.7	33.9	23.8	1.5	1.4	1.2	10%	8%	58%
MK Restaurant	M TB	Dec	1,698	THB	57.50	N.R.	N.R.	15.0	27.1	14.1	20.3	47.5	23.0	3.0	3.6	3.0	-18%	-3%	-25%
International Casual Dining Average								**21.0**	**24.3**	**16.7**	**47.7**	**54.8**	**38.1**	**4.2**	**3.9**	**3.5**	**-7%**	**-5%**	**-3%**
Mainland China QSR																			
Yum China	YUMC US	Dec	19,239	USD	51.11	58.00	Buy	13.2	15.8	10.0	27.2	39.3	21.4	2.2	2.4	1.9	6%	-1%	19%
Mainland China QSR Average								**13.2**	**15.8**	**10.0**	**27.2**	**39.3**	**21.4**	**2.2**	**2.4**	**1.9**	**6%**	**-1%**	**19%**
QSR Global																			
Mcdonalds	MCD US	Dec	138,190	USD	185.85	N.R.	N.R.	n/a	20.3	15.9	23.7	32.5	23.3	6.6	7.5	6.6	-6%	-8%	-12%
Starbucks	SBUX US	Sep	86,618	USD	74.14	N.R.	N.R.	19.2	28.2	17.0	31.6	55.7	26.8	3.4	3.6	3.1	-16%	-11%	-15%
Yum! Brands	YUM US	Dec	26,050	USD	86.55	N.R.	N.R.	17.5	20.5	17.5	24.4	29.7	22.8	4.7	4.8	4.3	-14%	-10%	-21%
Restaurant Brands	QSR US	Dec	28,337	CAD	74.23	N.R.	N.R.	16.9	20.7	17.0	20.0	26.1	19.9	5.0	5.6	5.0	-10%	-7%	-19%
Chipotle	CMG US	Dec	31,082	USD	1,114.43	N.R.	N.R.	42.5	57.9	32.2	79.3	122.5	58.8	5.6	5.5	4.7	33%	6%	49%
Domino'S Pizza US	DPZ US	Dec	15,028	USD	384.14	N.R.	N.R.	27.5	24.9	23.0	40.1	33.6	31.5	4.2	3.8	3.6	31%	2%	39%
Dunkin	DNKN US	Dec	5,419	USD	65.99	N.R.	N.R.	16.1	18.3	16.2	20.8	25.7	21.5	4.0	4.3	4.0	-13%	-7%	-19%
Wendy'S	WEN US	Dec	4,946	USD	22.21	N.R.	N.R.	18.0	17.7	16.2	37.6	41.4	33.0	2.9	2.9	2.8	0%	-2%	13%
Zensho	7550 JP	Mar	3,033	JPY	2,101.00	N.R.	N.R.	7.6	8.1	7.1	27.2	27.5	22.4	0.5	0.5	0.5	-15%	-8%	-9%
Jubilant Foodworks	JUBI IN	Mar	2,960	INR	1,685.40	N.R.	N.R.	26.6	27.4	20.0	64.3	83.7	54.2	5.8	5.9	5.0	1%	0%	35%
Greggs	GRG LN	Dec	2,031	GBP	15.89	N.R.	N.R.	6.6	16.2	7.4	17.7	n/a	22.9	1.4	2.0	1.4	-31%	-13%	-33%
Papa Johns	PZZA US	Dec	2,865	USD	88.26	N.R.	N.R.	25.2	21.6	18.4	75.4	67.1	41.7	1.8	1.6	1.6	40%	14%	92%
Domino'S Pizza UK	DOM LN	Dec	1,779	GBP	3.05	N.R.	N.R.	14.1	14.3	13.5	17.4	18.1	17.2	2.8	2.5	2.4	-5%	-13%	10%
Shake Shack	SHAK US	Dec	2,025	USD	49.05	N.R.	N.R.	23.8	54.9	23.1	68.1	n/a	168.6	3.4	3.7	2.9	-18%	-22%	-32%
Jack In The Box	JACK US	Sep	1,684	USD	74.27	N.R.	N.R.	11.0	12.0	11.1	17.8	19.3	15.7	1.7	1.7	1.6	-5%	2%	-9%
The Cheesecake Factory	CAKE US	Dec	975	USD	21.45	N.R.	N.R.	5.5	40.1	7.1	8.2	n/a	18.9	0.4	0.5	0.4	-45%	-28%	-51%
QSR Global Average								**18.5**	**25.2**	**16.4**	**35.9**	**44.8**	**37.5**	**3.4**	**3.5**	**3.1**	**-4%**	**-7%**	**1%**
HK Listed QSR																			
Café De Coral	341 HK	Mar	1,134	HKD	15.00	N.R.	N.R.	9.0	7.9	6.3	24.1	21.8	17.8	1.1	1.1	1.0	-19%	-3%	-36%
Fairwood	52 HK	Mar	285	HKD	17.08	N.R.	N.R.	7.9	7.7	5.2	21.6	22.0	13.1	0.8	0.8	0.8	-14%	-3%	-35%
Ajisen	538 HK	Dec	182	HKD	1.29	N.R.	N.R.	2.4	-4.9	2.7	8.4	23.5	4.2	0.5	0.5	0.5	-53%	-9%	-60%
HK Listed QSR Average								**6.4**	**3.6**	**4.7**	**18.0**	**22.5**	**11.7**	**0.8**	**0.8**	**0.8**	**-29%**	**-5%**	**-44%**
Asia Listed QSR																			
Jollibee	JFC PM	Dec	3,109	PHP	140.00	N.R.	N.R.	13.5	35.0	10.5	24.4	n/a	41.7	0.9	1.0	0.8	-35%	6%	-50%
Gourmet Master	2723 TW	Dec	604	TWD	98.80	N.R.	N.R.	n/a	3.1	2.6	19.1	23.6	14.7	0.8	0.9	0.8	-20%	-17%	-39%
Asia Listed QSR Average								**13.5**	**19.1**	**6.5**	**21.7**	**23.6**	**28.2**	**0.8**	**0.9**	**0.8**	**-28%**	**-5%**	**-45%**

Source: Refinitiv Datastream, HSBC estimates

Figure 126. Global condiment comp sheet

Company	BLM code	CY end	Mkt cap USDm	Ccy	Price 9-Jul	HSBC TP	HSBC Rating	EV/EBITDA (x) CY19	EV/EBITDA (x) CY20e	EV/EBITDA (x) CY21e	PE (x) CY19	PE (x) CY20e	PE (x) CY21e	P/Sales (x) CY19	P/Sales (x) CY20e	P/Sales (x) CY21e	Share performance YTD	Share performance 1M	Share performance 12M
Condiment Market																			
China/HK Market																			
Foshan Hai Tian	603288 CH	Dec	59,664	CNY	128.64	N.R.	N.R.	61.5	54.1	45.5	78.0	65.3	55.3	21.1	18.3	15.8	44%	14%	51%
Yihai	**1579 HK**	**Dec**	**12,867**	**HKD**	**95.25**	**116.40**	**Buy**	**79.0**	**59.9**	**45.6**	**116.1**	**96.6**	**71.8**	**20.8**	**16.4**	**12.0**	**108%**	**34%**	**123%**
Jonjee Hi-Tech	600872 CH	Dec	6,819	CNY	59.80	N.R.	N.R.	n/a	38.6	30.9	66.4	56.3	44.7	10.2	8.9	7.4	52%	16%	46%
Sichuan Teway	603317 CH	Dec	5,173	CNY	60.33	N.R.	N.R.	102.3	85.7	66.9	117.6	101.7	79.2	20.9	15.8	11.8	95%	27%	99%
Jig.Hengshun	600305 CH	Dec	2,728	CNY	19.00	N.R.	N.R.	39.5	39.4	34.3	58.6	53.5	46.0	10.4	9.2	8.0	60%	10%	45%
Mainland China/HK Market Average								**70.3**	**55.4**	**44.5**	**87.6**	**74.9**	**59.5**	**16.7**	**13.7**	**11.0**	**72%**	**20%**	**73%**
International Market																			
Kikkoman	2801 JP	Mar	8,810	JPY	4,875.00	N.R.	N.R.	16.8	16.9	15.7	34.4	36.5	33.5	2.0	2.1	2.0	-9%	-9%	3%
Ingredion	INGR US	Dec	5,452	USD	81.41	N.R.	N.R.	7.6	8.0	7.6	12.2	13.0	11.7	0.9	0.9	0.9	-12%	-10%	-2%
International Market Average								**12.2**	**12.5**	**11.6**	**23.3**	**24.8**	**22.6**	**1.5**	**1.5**	**1.5**	**-11%**	**-10%**	**1%**
Condiment Market Average								**51.0**	**43.1**	**35.1**	**69.2**	**60.6**	**49.0**	**12.3**	**10.2**	**8.3**	**48%**	**12%**	**52%**
Beverage, Instant Food Market																			
Mainland China/HK Market																			
Tingyi	322 HK	Dec	9,129	HKD	12.58	N.R.	N.R.	7.0	7.5	6.8	24.3	21.2	19.3	1.0	1.0	1.0	-5%	-3%	-4%
Uni-President China	220 HK	Dec	4,587	HKD	8.23	N.R.	N.R.	9.3	9.1	8.5	23.7	22.5	20.7	1.5	1.4	1.4	1%	5%	-9%
Mainland China/HK Market Average								**8.1**	**8.3**	**7.7**	**24.0**	**21.8**	**20.0**	**1.3**	**1.2**	**1.2**	**-2%**	**1%**	**-6%**
International Market																			
Coca Cola	KO US	Dec	193,571	USD	45.07	N.R.	N.R.	19.1	21.2	19.0	21.4	24.3	21.5	5.2	5.9	5.4	-19%	-10%	-13%
Pepsico	PEP US	Dec	186,230	USD	134.22	N.R.	N.R.	16.3	16.8	15.4	24.3	25.2	22.9	2.8	2.8	2.6	-2%	2%	1%
Keurig Dr Pepper	KDP US	Dec	40,259	USD	28.61	N.R.	N.R.	17.0	14.5	13.0	23.5	20.7	18.4	3.6	3.5	3.4	-1%	1%	-4%
Monster Beverage	MNST US	Dec	37,786	USD	71.76	N.R.	N.R.	24.8	24.0	21.2	35.2	34.4	29.8	9.0	8.8	8.0	13%	2%	9%
Mccormick & Company	MKC US	Nov	24,460	USD	183.64	N.R.	N.R.	24.9	23.6	23.1	34.2	32.8	32.8	4.6	4.5	4.4	8%	6%	15%
Fomento Economico Mexicano	FEMSAUBD MM	Dec	21,164	MXN	137.00	N.R.	N.R.	6.9	7.6	6.5	133.0	27.2	19.3	0.9	0.9	0.8	-23%	-14%	-26%
Coca Cola European Partners	CCEP US	Dec	17,626	USD	38.81	N.R.	N.R.	9.4	12.2	9.9	13.7	20.4	14.6	1.3	1.5	1.3	-24%	-11%	-33%
Suntory Beverage & Food	2587 JP	Dec	12,687	JPY	4,405.00	N.R.	N.R.	7.7	7.8	6.9	19.8	21.1	19.3	1.0	1.1	1.0	-3%	0%	-6%
J M Smucker	SJM US	Apr	11,948	USD	104.71	N.R.	N.R.	10.4	10.3	9.9	12.5	12.6	12.6	1.5	1.6	1.6	1%	-6%	-12%
Coca-Cola Hbc	CCH LN	Dec	9,366	GBP	20.39	N.R.	N.R.	8.6	10.6	9.0	15.6	21.2	16.5	1.2	1.3	1.2	-21%	-7%	-28%
Ito En	2593 JP	Apr	5,833	JPY	6,200.00	N.R.	N.R.	16.5	16.6	16.3	52.8	52.9	51.7	1.3	1.3	1.3	13%	3%	19%
International Market Average								**14.7**	**15.0**	**13.7**	**35.1**	**26.6**	**23.6**	**2.9**	**3.0**	**2.8**	**-5%**	**-3%**	**-7%**
Beverage, Instant Food Market Market Average								**13.7**	**14.0**	**12.7**	**33.4**	**25.9**	**23.0**	**2.7**	**2.7**	**2.6**	**-5%**	**-3%**	**-7%**

Source: Refinitiv Datastream, HSBC estimates

Notes

Notes

Notes

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Upside/Downside is the percentage difference between the target price and the share price.

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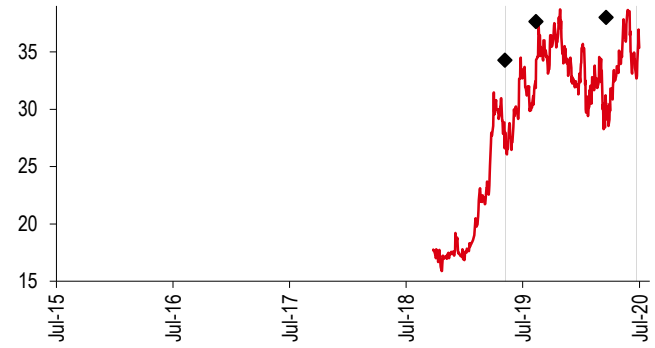
Share price and rating changes for long-term investment opportunities

Haidilao International (6862.HK) share price performance HKD Vs HSBC rating history



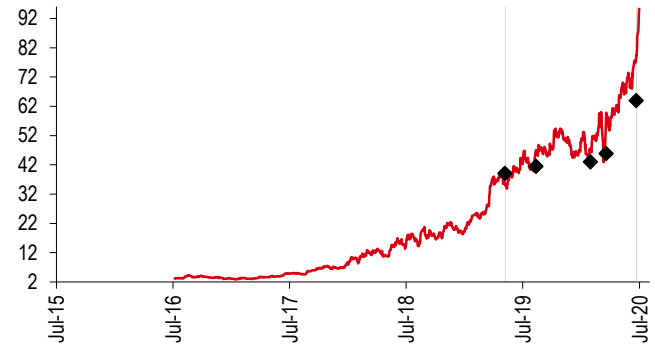
Source: HSBC

Rating & target price history

From	To	Date	Analyst
N/A	Buy	15 May 2019	Katharine Song
Buy	N/A	01 Jul 2020	
Target price	**Value**	**Date**	**Analyst**
Price 1	34.28	15 May 2019	Katharine Song
Price 2	37.64	21 Aug 2019	Katharine Song
Price 3	38.00	27 Mar 2020	Katharine Song
Price 4	N/A	01 Jul 2020	

Source: HSBC

Yihai International (1579.HK) share price performance HKD Vs HSBC rating history



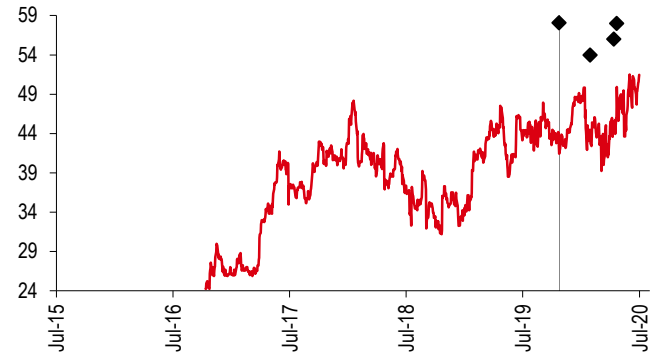
Source: HSBC

Rating & target price history

From	To	Date	Analyst
N/A	Hold	15 May 2019	Katharine Song
Hold	N/A	01 Jul 2020	
Target price	**Value**	**Date**	**Analyst**
Price 1	39.10	15 May 2019	Katharine Song
Price 2	41.53	21 Aug 2019	Katharine Song
Price 3	43.00	07 Feb 2020	Katharine Song
Price 4	45.90	27 Mar 2020	Katharine Song
Price 5	64.00	30 Jun 2020	Katharine Song
Price 6	N/A	01 Jul 2020	

Source: HSBC

Yum China Holdings Inc (YUMC.N) share price performance USD Vs HSBC rating history



Source: HSBC

Rating & target price history

From	To	Date	Analyst
N/A	Buy	01 Nov 2019	Lina Yan
Target price	**Value**	**Date**	**Analyst**
Price 1	58.10	01 Nov 2019	Lina Yan
Price 2	54.00	06 Feb 2020	Lina Yan
Price 3	56.00	20 Apr 2020	Lina Yan
Price 4	58.00	29 Apr 2020	Lina Yan

Source: HSBC

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Disclosure checklist

Company	Ticker	Recent price	Price date	Disclosure
HAIDILAO INTERNATIONAL	6862.HK	35.35	09 Jul 2020	7
JIUMAOJIU INTL LTD	9922.HK	13.28	09 Jul 2020	7
YUM CHINA HOLDINGS INC	YUMC.N	51.48	09 Jul 2020	7

Source: HSBC

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考研资料：数学、英语、政治、管综、西综、法硕等（整合各大机构）
英语类：四六级万词班专四专八雅思等
财经类：初级会计、中级会计、注册会计、高级会计、税务师、会计实操、证券从业、基金从业、资产评估、初级审
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